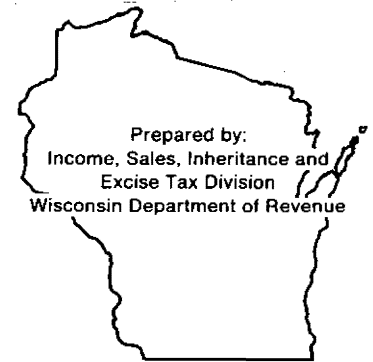


# WISCONSIN TAX BULLETIN

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**JANUARY 1985  
NUMBER 40**



## FORMS 1099-G MAILED TO TAXPAYERS

Federal law requires that the Department of Revenue provide information returns (called Form 1099-G) to individuals who received a Wisconsin income tax refund during 1984. Approximately 780,000 Forms 1099-G reporting refunds received during 1984 from 1983 Wisconsin income tax returns will be mailed to Wisconsin taxpayers later this month.

Only those taxpayers who claimed itemized deductions on their 1983 federal income tax returns should receive Forms 1099-G. If deductions were not itemized a state income tax refund is not reportable as taxable income on a federal return. The Department is not required to issue a Form 1099-G to such persons.

Included with each Form 1099-G mailed to taxpayers will be an informational flyer which explains how the refund amount which is shown on the Form 1099-G was determined.

As reported in *Wisconsin Tax Bulletin* Number 39, a ruling recently received from the Internal Revenue Service changes the manner in which refunds must be reported on a Form 1099-G for two categories of married persons. For 1983, when a Form 1099-G was prepared for a married person who had offset part of his or her refund against tax owed by his or her spouse on a combined income tax return they filed, only the net refund (amount after the offset) was reported on the 1099-G. For 1984 the IRS requires that the full amount of refund (amount before the offset) be reported on Form 1099-G. For example, on their 1983 return spouse A had a refund of \$300 which was applied against \$100 of tax due of spouse B, and a refund check of \$200 ( $\$300 - \$100 = \$200$ ) was issued to spouse A in 1984. Based on the IRS ruling, the gross amount of refund (\$300 in this example) must be reported on the 1984 Form 1099-G prepared for spouse A, rather than

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the net amount of refund (\$200 in this example).

Another difference from 1983 to 1984 involves 1099-G's prepared for spouses who filed a combined Wisconsin income tax return on which both the husband and wife received

a refund. For 1983 a single Form 1099-G was prepared showing the total of both refunds. For 1984 a separate Form 1099-G must be prepared for each spouse reflecting only his or her own refund. For example, on their 1983 return, spouse A showed a refund of \$150 and spouse B a refund of \$75. One refund check of \$225 was sent to them in 1984. Based on the IRS ruling a separate 1984 Form 1099-G must be prepared for each spouse showing that spouse's refund. In this example, the Form 1099-G prepared for spouse A would show a refund of \$150 and the Form 1099-G for spouse B would show a \$75 refund.

## TWO NEW TAX FORMS FOR 1984

Changes in Wisconsin income tax law for 1984 have resulted in the following two new forms for 1984:

1. **Schedule 2440-W — Disability Income Exclusion**  
This form is to be used to determine what amount, if any, of disability income may be excluded from an individual's Wisconsin taxable income. The disability income exclusion previously available for federal income tax purposes (before it was replaced by a credit for 1984) continues to apply for Wisconsin. A disability income exclusion of up to \$5,200 will be allowed to persons under age 65 who have retired on disability and receive disability income while permanently and totally disabled. The requirements of Section 105(d) of the Internal Revenue Code immediately prior to its repeal in 1983 by Public Law 98-21 will continue to be used for Wisconsin in 1984 and thereafter.
2. **Schedule R — Wisconsin Research Credits**  
Beginning with the 1984 taxable year, two new research credits are available: (1) a credit for in-

creasing research activities in Wisconsin, and (2) a credit for Wisconsin research facility expenditures. The credits are available to corporations, individuals, estates and trusts. Regardless of which type of taxpayer is involved, Schedule R is to be used to compute the amount of credit allowable.

Copies of both of these new forms and the related instructions are included on pages 27 through 32 of this issue.

### **HOMESTEAD CREDIT FORM REVISED FOR 1984**

New schedules have been added to the back of Schedule H (the homestead credit claim) for certain persons to compute their income and allowable property taxes or rent.

- Claimants with homes that were on more than one acre of land and were not part of a farm may claim only the property taxes or rent on their home and one acre of land. These claimants should use Schedule 1, *Allowable Taxes for Home on More Than One Acre of Land*, to compute their allowable property taxes.
- Claimants who used part of their property for business or rental purposes (other than farming) may claim only the property taxes or rent related to personal use. These claimants should use Schedule 2, *Allowable Taxes/Rent if Property Used Partly for Business or Rental Purposes*, to compute their allowable property taxes or rent.
- Claimants who received AFDC of any amount or general relief payments of \$400 or more for any month of 1984 may claim only the property taxes or rent for those months in which they did not receive AFDC or general relief. These claimants should use Schedule 3, *Taxes/Rent Reduction for AFDC or General Relief Recipients*, to compute their allowable property taxes or rent.
- Claimants who received any type of cash public assistance or relief must include the amount in household income for homestead credit purposes. These claimants should use Schedule 4, *Income from Cash Public Assistance and Relief Programs*, to report the

source and amount of any cash public assistance received each month.

### **NEW EXTENSION FORMS INCLUDE ESTIMATED TAX PAYMENT VOUCHER**

The forms used by individuals and corporations to request an extension of time to file Wisconsin income and franchise tax returns have been revised for 1984. Included at the bottom of both the form for individuals and for corporations is a declaration voucher which can be used to make an estimated tax payment for 1984 at the time an extension of time to file is requested. A payment of estimated tax for 1984 with an extension request will reduce or eliminate interest payable during an extension period.

Any estimated tax payment made for 1984 by using the voucher from the extension request form should be added together with other estimated tax payments made for 1984. The total should be claimed as a credit on the estimated tax entry line on the 1984 income or franchise tax return filed by the taxpayer.

### **USE PREADDRESSED DECLARATION VOUCHERS**

The Department provides computer prepared declaration of estimated tax payment vouchers, which include the taxpayers' names, addresses and account identification numbers, to both individual and corporate taxpayers. Although these vouchers are mailed to taxpayers, a substantial number do not use them. In many instances, a practitioner prepared voucher is apparently being used instead.

When an estimated tax payment is accompanied by a voucher which is not the preaddressed voucher prepared by the Department, all of the name, address and identification number information shown on it must be manually verified when the payment is processed. This is necessary to ensure that the payment is credited to the correct taxpayer. Processing a substitute voucher takes longer and that results in increased costs to the state. To avoid the extra costs, tax return preparers are asked to encourage their clients to use the preaddressed vouchers which the Department mails to them.

### **1A'S BY TAX PREPARERS**

Wisconsin's "Short Form" (Form 1A) is intended to be a simple form for taxpayers to prepare themselves and, therefore, does not provide space in the signature area for a separate identification of a tax preparer. However, many tax preparers are stamping and signing Form 1A in areas required for Department use. This practice causes extra handling and extra cost in the processing of these practitioner-prepared forms.

Practitioners who wish to place their identification on Form 1A should therefore place their name on the bottom of the second page (reverse side) of the form in order to expedite processing of the returns they prepare. Note that the Department of Revenue does not require a tax preparer's identification on the Wisconsin "Short Form" (1A).

### **EDUCATIONAL ASSISTANCE PROGRAM BENEFITS ARE TAXABLE FOR WISCONSIN**

Internal Revenue Code Section 127 permits employers to set up educational assistance programs under which employees can receive tax-free educational benefits. The December 31, 1983 Internal Revenue Code Section 127(d) states that the exclusion for educational assistance benefits terminates and does not apply to taxable years beginning after December 31, 1983. Federal legislation (P.L. 98-611) was enacted during 1984 to restore this exclusion for the 1984 and 1985 taxable years. Up to \$5,000 of such benefits are not taxable for federal purposes because of the federal legislation.

Wisconsin adjusted gross income for the 1984 taxable year is based on the Internal Revenue Code in effect on December 31, 1983. Amendments to the Code enacted after December 31, 1983 do not apply for Wisconsin. Therefore, educational assistance benefits are includable in Wisconsin income for the 1984 taxable year.

Employers should report the amount of educational assistance benefits as additional compensation on the employee's 1984 Wisconsin wage statement (Form W-2). Thus, the amount of federal compensation will differ from the amount of Wisconsin compensation. Alternatively, the em-

ployer may report the educational assistance benefits on a supplemental wage statement for Wisconsin.

Employees are not required to report educational assistance benefits as income on their 1984 federal returns. However, employees must report such benefits as taxable income on their 1984 Wisconsin returns.

## REMINDER OF MAJOR LAW CHANGES FOR 1984

Listed below are some of the major changes for 1984 that relate to income tax, corporation franchise/income tax, homestead credit and farmland credit. Also listed are some of the federal laws enacted in 1984 which do not apply for Wisconsin purposes.

For information about other new laws enacted in 1984 pertaining to these taxes and credits, see *Wisconsin Tax Bulletin* Number 37 (May 1984 issue).

## INDIVIDUAL INCOME TAXES

### 1. Eliminate 10% Surtax for 1984.

The 10% surtax to the Wisconsin income tax and minimum tax rates has been eliminated for the entire 1984 taxable year.

### 2. Update Internal Revenue Code Reference for 1984 Taxable Year.

For the 1984 taxable year and thereafter, individuals, estates and trusts will use the Internal Revenue Code in effect on December 31, 1983 with the following exceptions.

The following Internal Revenue Code provisions which were in effect on December 31, 1983 will *not* apply for Wisconsin:

- The inclusion in gross income of a portion of social security and railroad retirement benefits as required under Sections 86 and 72(r) of the IRC. These benefits continue to be nontaxable for Wisconsin.
- The inclusion in gross income of sick pay benefits paid under the Railroad Unemployment Insurance Act as required by Section 105(i) of the IRC. These benefits continue to be nontaxable for Wisconsin.
- The deduction from gross income allowed two-earner married couples under Section 221 of the IRC.

- The exclusion from gross income allowed for public utility dividends which are reinvested in the common stock of the utility as provided under Section 305(e) of the IRC.
- The charitable contributions deduction allowed to persons who do not claim itemized deductions as provided under Section 170(i) of the IRC.
- The incentive stock option provisions as provided under Section 422A of the IRC.

In addition to the above differences, Wisconsin and federal law for 1984 and thereafter will also differ with respect to the following items:

- Political contributions continue to be allowed as an itemized deduction for Wisconsin.
- The foreign earned income exclusion which was allowed to persons who worked abroad, as provided by the IRC as of December 31, 1977, continues to apply for Wisconsin. (The new foreign earned income exclusion limits and deduction provisions enacted in Sections 111 and 113 of Public Law 97-34 may not be used for Wisconsin.)
- The disability income exclusion of up to \$5,200 which was allowed to persons under age 65 who retired on disability and received disability income while permanently and totally disabled, as provided under Section 105(d) of the IRC immediately prior to its repeal in 1983 by Public Law 98-21, continues to apply for Wisconsin. (For federal purposes, this exclusion has been replaced by a nonrefundable federal income tax credit for taxable years beginning after December 31, 1983.)

Changes to federal law enacted after December 31, 1983 do not apply for Wisconsin. For example, changes made by the federal Tax Reform Act of 1984 may not be used for Wisconsin for 1984. A complete listing of these differences is included in the Schedule I instructions found on pages 33 through 46 of this Bulletin.

### 3. Provide Child Care Credit Equal to 30% of Federal Credit.

Individuals may claim a nonrefundable credit equal to 30% of the federal child and dependent care credit, prior to adjustments for federal tax

credits and federal tax liability, for which they are eligible for the taxable year under Section 44A of the IRC as amended to December 31, 1983.

Married persons may divide the credit between them in any manner they choose. In order for married persons to claim the credit, they must report their income on the same Wisconsin income tax return.

The credit may be claimed by full-year and part-year residents of Wisconsin for taxable years 1984 and thereafter. Part-year residents must reduce their credit by 1/12 for any month in which they do not reside in Wisconsin (15 days or more is considered a month). Nonresidents are not eligible.

### 4. Provide Earned Income Credit Equal to 30% of Federal Credit.

Individuals may claim a nonrefundable credit equal to 30% of the federal earned income credit for which they are eligible for the taxable year under Section 43 of the IRC as amended to December 31, 1983.

Married persons may divide the credit between them in any manner they choose. In order for married persons to claim the credit, they must report their income on the same Wisconsin income tax return. Part-year residents and nonresidents are not eligible for the credit.

### 5. Provide Research Credits for 5% of Qualified Research Expenses and 5% of Facility Costs.

These credits may be claimed by individuals, estates, trusts and corporations. Partnerships and Tax-option (S) corporations may not claim the credits; however, the individual partners or shareholders may claim the credits that are passed through from the partnership or Tax-option corporation. The credits are computed on Schedule R, which is on page 29 of this Bulletin.

## CORPORATION FRANCHISE/INCOME TAXES

### 1. Eliminate 10% Surtax for 1984.

The 10% surtax to the Wisconsin franchise/income tax rates has been eliminated for the entire 1984 taxable year.

### 2. Increase Deduction for Cash Dividends Received From 80% Owned Subsidiaries.

The deduction for cash dividends received by corporations owning, during the entire taxable year, at least 80% of

the total combined voting stock of the payor corporation has been increased to 75% for the 1984 taxable year.

**3. Provide Deduction for Payments to Deferred Payment Plans.** Contributions to deferred payment plans (e.g., pension, profit-sharing and stock bonus plans) which meet the requirements of Section 401 of the IRC and that are made on or before the date on which a corporation is required to file its Wisconsin franchise/income tax return (including extensions) are deemed to have been made on the last day of the taxable year for which that return is filed. The limitations of Section 404 of the IRC apply. This new law is effective for plan years beginning after September 2, 1974.

**4. Provide Research Credits for 5% of Qualified Research Expenses and 5% of Facility Costs.** Credits may be claimed against Wisconsin franchise/income taxes due for increasing research expenses and/or for expenditures for research facilities.

A claimant may claim as a credit an amount equal to 5% of qualified research expenses incurred for research conducted in Wisconsin for the taxable year, less "base period" research expenses incurred for research conducted in Wisconsin. Qualified research expenses and base period research expenses are determined according to the definitions in Section 44F of the IRC as amended to December 31, 1983.

A claimant may also claim as a credit an amount equal to 5% of the amount paid or incurred during the taxable year for tangible personal property (not replacement property) used to construct and equip new facilities or expand existing facilities in Wisconsin for qualified research, as defined in Section 44F of the IRC. The credits are computed on Schedule R, which is on page 29 of this Bulletin.

#### **HOMESTEAD CREDIT**

**1. Increase Household Income Limit to \$16,500.** No homestead credit will be allowed if household income exceeds \$16,500. (For 1983 claims, the limit was \$15,500.)

**2. Change "Rent Constituting Property Taxes Accrued" Percentage From 20% to 25%.**

Claimants will be allowed 25% of rent paid for occupancy as "rent constituting property taxes accrued".

**3. Increase Property Taxes Limit to \$1,200.** The amount of property taxes or rent constituting property taxes for homestead credit purposes will be limited to \$1,200. (For 1983 claims, the limit was \$1,100.)

**4. Increase Acreage Limitation to 120 Acres When Home Is Part of a Farm.** Claimants with homes that are part of a farm may claim property taxes on the home and up to 120 acres adjoining it, including all improvements on this same 120 acres.

#### **FARMLAND PRESERVATION CREDIT**

**1. Eliminate Requirement That Claimant Be Owner of Land at End of Year.** A farmland preservation credit claimant will no longer be required to own at the close of the taxable year the farmland on which a credit is claimed. Thus, when farmland is sold, both the buyer and the seller (assuming both meet the required qualifications) will be eligible to file for farmland credit on the basis of the portion of the total property taxes each paid. Under prior law, only the buyer (owner at the end of the year) was eligible to file a farmland credit claim.

#### **IRS STANDARD MILEAGE RATE APPLIES FOR WISCONSIN**

The optional standard mileage rate specified by the IRS for computing business automobile expenses for 1984 also applies for Wisconsin. The rate is 20.5¢ for the first 15,000 business miles driven in an auto that is not fully depreciated. After 15,000 miles of business use in one year and for all mileage on a fully depreciated auto, the rate is 11¢ per mile. A rate of 9¢ per mile which is used to calculate auto expenses for charitable, medical and moving expense deductions for federal purposes also applies for Wisconsin for 1984.

#### **MADISON MAN CONVICTED OF INCOME TAX EVASION**

Donald M. Fadness of Madison, doing business as Fadness Petrographic Service, was convicted on

October 16, 1984 in Dane County Circuit Court by Judge Mark A. Frankel on two counts of state income tax evasion after he entered no contest pleas to the charges. Judge Frankel withheld sentencing and placed Fadness on probation for three years. Under the conditions of probation, Fadness must pay a total of \$15,000 in fines and serve 45 days in the Dane County jail with work release privileges beginning Friday, October 19. He must also make restitution of the state income taxes, penalties and interest due for each of the years 1978, 1979, 1980 and 1981, serve 125 hours in voluntary community service and file correct income tax returns during the probationary period.

Criminal charges were filed against Fadness by the Attorney General's office after an investigation by the Intelligence Section of the Wisconsin Department of Revenue. Fadness was charged with failing to report more than \$39,000 in taxable income for the years 1978, 1979, 1980 and 1981 and evading more than \$4,000 in state income taxes for those years.

Filing a false state income tax return is a crime punishable by a maximum fine of \$10,000 or imprisonment for five years 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 violation.

#### **HOW TO GET WISCONSIN INCOME TAX FORMS**

In December the Department placed nearly 2.3 million 1984 income tax and homestead credit forms in the mail to individuals who filed 1983 returns or claims.

Orders for bulk supplies of tax forms are now being shipped to tax practitioners and to organizations such as banks and libraries which distribute them to the public. These orders are expected to be filled by mid-January.

During the filing season, small supplies of forms can be obtained from any Wisconsin Department of Revenue office. However, requests will be limited to six copies of any single form. This is necessary to prevent the supply of forms at any office from being quickly depleted and then unavailable for other persons. Practi-

tioners or other persons requiring larger supplies should write the Wisconsin Department of Revenue, Central Services Section, Post Office Box 8903, Madison, WI 53708.

## INFORMATIONAL PUBLICATIONS AVAILABLE

The Department publishes informational material called "publications". These are small pamphlets which provide detailed information about specific areas of Wisconsin tax laws.

For 1984, the following publications may be obtained at any of the Department's offices located throughout Wisconsin:

Publication No.	Publication Title
100	1984 Wisconsin Tax Requirements for Nonresidents
101	1984 Wisconsin Tax Requirements for Part-Year Residents
102	1984 Wisconsin Tax Treatment of Tax-Option (S) Corporations and Their Shareholders
103	Reporting Capital Gains and Losses for Wisconsin by Individuals, Estates and Trusts
104	Wisconsin Taxation of Military Personnel
105	Adoption Expenses: Wisconsin Tax Benefits for 1984
107	Combining DISC and Parent or Affiliated Corporations' Incomes
200	How Electrical Contractors Determine Their Wisconsin Sales and Use Tax
201	Wisconsin Sales and Use Tax Information
202	How Wisconsin Sales and Use Tax Applies to Motor Vehicle Sales, Leases and Repairs
203	Sales and Use Tax Information for Manufacturers
300	Alcohol Beverage Laws Relating to Underaged Persons
500	Tax Guide for Wisconsin Political Organizations and Candidates
501	Field Audit of Wisconsin Tax Returns
503	Wisconsin Farmland Preservation Tax Credit for 1984
504	Directory for Wisconsin Department of Revenue
508	Wisconsin Tax Requirements Relating to Nonresident Entertainers

Publication 102 explains the Wisconsin tax treatment of Tax-option (S) corporations and their shareholders. The federal Subchapter S Revision Act of 1982 and the federal Tax Reform Act of 1984 made changes to the eligibility for Subchapter S status and the rules relating to the treat-

ment of income, losses, distributions and terminations of S corporations for taxable years beginning after December 31, 1982. Wisconsin does *not* follow all of the federal law changes. A copy of the publication is included in this Bulletin, beginning on page 47, to help tax practitioners prepare Wisconsin tax returns for Tax-option corporations and their shareholders.

If you have suggestions for additional subjects which you believe should be covered by a publication, submit your suggestions to the Wisconsin Department of Revenue, Director of Technical Services, P.O. Box 8910, Madison, Wisconsin 53708.

## 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 December 1, 1984. Part C 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  
11.10 Occasional sales-A  
11.65 Admissions-A

### C. 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)  
11.05 Governmental units-A (10/1/84)  
11.08 Medical appliances, prosthetic devices and aids-A (10/1/84)

11.09 Medicines-A (10/1/84)  
11.10 Occasional sales-A (10/1/84)  
11.11 Waste treatment facilities-A (10/1/84)  
11.12(4) Farming, agriculture, horticulture and floriculture-A (10/1/84)  
11.12(5) Farming, agriculture, horticulture and floriculture-A (10/1/84)  
11.13 Sale of a business or business assets-A (10/1/84)  
11.15 Containers and other packaging and shipping materials-A (1/1/84, 10/1/84)  
11.16 Common or contract carriers-A (1/1/84)  
11.17 Hospitals, clinics and medical professions-A (10/1/84)  
11.19 Printed material exemptions-A (1/1/84, 10/1/84)  
11.26 Other taxes in taxable gross receipts and sales price-A (1/1/84)  
11.27 Warranties-A (10/1/84)  
11.30 Credit sale, bad debt and repossessions-A (10/1/84)  
11.32(3) "Gross receipts" and "sales price"-A (1/1/84)  
11.39 Manufacturing-A (10/1/84)  
11.45 Sales by pharmacies and drug stores-A (10/1/84)  
11.48 Landlords, hotels and motels-A (1/1/84)  
11.50 Auctions-A (1/1/84)  
11.51 Grocer's guidelist-A (10/1/84)  
11.52 Coin-operated vending machines and amusement devices-A (1/1/84)  
11.56 Printing industry-A (10/1/84)  
11.65 Admissions-A (10/1/84)  
11.67 Service enterprises-A (10/1/84)  
11.68 Construction contractors-A (1/1/84)  
11.72 Laundries, dry cleaners and linen and clothing suppliers-A (10/1/84)  
11.79 Leases of highway vehicles and equipment-A (10/1/84)  
11.83 Motor vehicles-A (10/1/84)  
11.85 Boats, vessels and barges-A (10/1/84)  
11.86 Utility transmission and distribution lines-A (10/1/84)  
11.87 Meals, food, food products and beverages-A (10/1/84)  
11.94 Wisconsin sales and taxable transportation charges-A (10/1/84)  
11.95 Retailer's discount-A (10/1/84)

## ISI&E DIVISION OFFERS TAXPAYER ASSISTANCE

During the 1985 filing season (January through April 15th), the division's auditors and tax representatives will be available to answer questions.

In the Department's larger offices, assistance is provided on a daily basis (Monday through Friday). Assistance in other offices generally is available on Mondays only, although there are two exceptions as noted below.

### Offices Providing Daily Assistance

<u>Location</u>	<u>Address</u>	<u>Telephone No.</u>	<u>Hours</u>
*Appleton	265 W. Northland	(414)735-5001	7:45-4:30
*Eau Claire	718 W. Clairemont	(715)836-2811	7:45-4:30
*Green Bay	200 N. Jefferson St.	(414)497-4230	7:45-4:30
*Kenosha	5500 - 8th Ave.	(414)656-7100	7:45-4:30
*LaCrosse	620 Main	(608)785-9720	7:45-4:30
*Madison	4638 University Ave.	(608)266-2772	7:45-4:30
Madison	212 East Washington Ave.	NONE	8:00-4:15
*Milwaukee	819 N. Sixth St.	(414)224-4000	7:45-4:30
*Racine	616 Lake Ave.	(414)636-3711	7:45-4:30
*Waukesha	141 N.W. Barstow St.	(414)521-5310	7:45-4:30

### Offices Providing Assistance on Mondays Only (unless otherwise noted)

Ashland	Courthouse	NONE	10:00-2:00 (a)
Baraboo	1007 Washington	(608)356-8973	7:45-4:30
Barron	57 S. 4th St.	(715)537-3621	7:45-4:00
Beaver Dam	211 S. Spring St.	(414)887-8108	7:45-4:30
Cedarburg/Grafton	220 Oak Street	(414)377-6700	7:45-4:30
Elkhorn	300 S. Lincoln St.	(414)723-4098	7:45-4:30
Fond du Lac	160 S. Macy St.	(414)929-3985	7:45-4:30
Hayward	221 Kansas Ave.	(715)634-8478	8:00-12:00
Hudson	759 Sommer St. No.	(715)386-8225	7:45-4:30
Janesville	115 S. Franklin	(608)755-2750	7:45-4:30 (b)
Lancaster	237 W. Hickory St.	(608)723-2641	7:45-4:30
Manitowoc	1314 Memorial Dr.	(414)683-4152	7:45-4:30
Marinette	Courthouse	(715)735-5498	9:00-12:00
Marshfield	630 S. Central Ave.	(715)387-6346	7:45-4:30
Monroe	1220 - 16th Ave.	(608)325-3013	7:45-4:30
Oshkosh	404 N. Main St.	(414)424-2100	7:45-4:30
Park Falls	1114 S. 4th Ave.	(715)762-2160	7:45-11:45
Rhineland	Sunrise Plaza	(715)362-6749	7:45-4:30
Shawano	1456 E. Green Bay St.	(715)526-5647	7:45-4:30
Sheboygan	504 S. 14th St.	(414)459-3101	7:45-4:30
Superior	Courthouse	(715)394-0204	8:00-4:30
Tomah	City Hall	(608)372-3256	8:30-12:00
Watertown	415 E. Main St.	(414)261-7700	7:45-4:30
Waupaca	201½ S. Main St.	(715)258-9564	7:45-11:45
Wausau	Courthouse Annex	(715)847-5380	7:45-4:30
West Bend	429 Walnut St.	(414)338-4730	7:45-4:30
Wisconsin Rapids	1681 Second Ave. S.	(715)421-0500	7:45-4:30

(a) Tuesdays only

(b) Monday through Wednesday

\* Open during noon hour

## 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:

### Individual Income Taxes

Frederick J. Blask

Fraud penalty

Douglas Evers

Claims for refunds — statute of limitations

Tadeusz Jaworski and Halina Jaworski

Basis of assets

Marie L. Menacher

Interest on assessments

Edwin J. Puissant, Jr.

Travel expenses

### Corporation Franchise/Income Taxes

Allen-Bradley Company

Worthless stock deduction

NCR Corporation

Deductions — federal income taxes

### Sales/Use Taxes

Specialty Associates, Inc.

Construction contractors

### Cigarette Tax

George R. Elliott

Penalty — delinquent tax payment

## INDIVIDUAL INCOME TAXES

**Frederick J. Blask vs. Wisconsin Department of Revenue** (Wisconsin Tax Appeals Commission, August 21, 1984). The sole issue before the Commission is whether the department acted properly in imposing the 50% penalty provided in s.

71.11(6)(b), Wis. Stats., for 1980 and 1981.

The taxpayer was a successful insurance salesman for American Family and derived the following income:

1979	\$44,497.94
1980	\$46,357.02
1981	\$46,239.83

Up until 1979, the taxpayer filed his annual Wisconsin income tax returns and paid the tax due on a timely basis. Sometime during 1979/1980, the taxpayer attended a seminar run by Irwin Schiff, a self-avowed "tax protester". Irwin Schiff convinced the taxpayer that he had a so-called "constitutional right" not to file federal or state income tax returns or pay income taxes to the federal government or the State of Wisconsin. One of the primary justifications, which the taxpayer accepted, for non-filing and non-payment was the contention that, because U. S. currency was no longer backed by gold, it was not subject to taxation. The taxpayer now concedes that he was "duped" by Irwin Schiff and seeks to make amends.

Despite repeated requests by the department, the taxpayer refused to file timely Wisconsin individual income tax returns and pay the taxes due for 1979, 1980 and 1981. The taxpayer cited repeatedly that it was, in effect, his "constitutional right" not to file or pay income taxes to the State of Wisconsin.

On January 24, 1984, the taxpayer was indicted by a Grand Jury of the United States District Court for the Eastern District of Wisconsin on three counts of failing to file an income tax return and pay the federal income taxes due for the years 1979, 1980 and 1981. He subsequently entered a guilty plea to these charges, pursuant to a plea agreement with the United States Attorney for the Eastern District of Wisconsin.

On January 31, 1983, the taxpayer finally filed his original 1979 Wisconsin individual income tax return with the department and in February 1983, he filed his original 1980 and 1981 Wisconsin individual income tax returns.

Under date of March 28, 1983, the department issued an assessment against the taxpayer in which it imposed the 50% penalty provided in s. 71.11(6)(b), Wis. Stats., for both 1980 and 1981.

The Commission held that the fact that the taxpayer was "duped" into believing he did not have to file Wisconsin individual income tax returns and pay the taxes due for 1979, 1980 and 1981 does not relieve him of his responsibility to comply with the provisions of Chapter 71 of the Wisconsin Statutes. The department met its burden of proof to establish by clear and convincing evidence that the taxpayer's failure to file timely Wisconsin individual income tax returns for 1979, 1980 and 1981 was with the intent to defeat or evade the income tax assessment required of him by law. Under the provisions of s. 71.11(6)(b), Wis. Stats., the department's action was proper in assessing the 50% penalty.

The taxpayer has not appealed this decision.

**Douglas Evers vs. Wisconsin Department of Revenue** (Wisconsin Tax Appeals Commission, August 21, 1984). On October 11, 1982, the taxpayer filed late Wisconsin individual income tax returns with the department for the calendar years 1977 and 1978. On his late 1977 return, the taxpayer showed an income tax overpayment of \$231, which he elected to have applied to his 1978 income tax liability. On his late 1978 return, the taxpayer showed a net tax due of \$101. He then claimed the 1977 overpayment of \$231 as a credit to arrive at a 1978 overpayment of \$130.

The department disallowed the carryover of the \$231 overpayment claimed on the taxpayer's 1977 income tax return to his 1978 return, because the 1977 return was filed beyond the four year period provided by s. 71.10(10)(bn), Wis. Stats.

On October 10, 1983, the taxpayer filed a timely appeal of the department's action, in which he claimed that the provisions of s. 71.10(10)(bn) do not apply to "credits".

The Commission held that the \$231 overpayment claimed by the taxpayer on his 1977 return was in effect a claim for refund regardless of whether he wanted it directly refunded to him or applied as a credit to his 1978 Wisconsin income tax liability. Because his 1977 Wisconsin combined individual income tax return was filed more than four years late, he is barred from claiming the refund shown as a credit against his



1978 income tax liability, per the provisions of s. 71.10(10)(bn), Wis. Stats.

The taxpayer has not appealed this decision.

**Tadeusz Jaworski and Halina Jaworski vs. State of Wisconsin, Tax Appeals Commission, and Wisconsin Department of Revenue** (Court of Appeals, District III, August 7, 1984). The taxpayers are appealing a judgment upholding an \$8,083 additional income tax assessment against them for 1978. The Jaworskis sold part of their farm in 1978 and deducted a portion of their FmHA mortgage in calculating their capital gain on the sale. The Tax Appeals Commission disallowed the deduction. The mortgage proceeds were used to cover the Jaworskis' farm operating costs. Although some of these costs could have been capitalized, the record shows that the Jaworskis expensed the costs as they were incurred. (See WTB #30 for a summary of the Tax Appeals Commission's decision.)

The Jaworskis claim that they should have been allowed a deduction for the amounts they spent for fertilizer and land development. In the years before 1978, the Jaworskis expensed these costs by claiming them as deductions on Schedule F of their joint federal income tax returns. During these years, the farm showed net losses. These losses reduced the Jaworskis' federal income tax and, in part, their state income tax.

The Jaworskis could have capitalized their liming, fertilizing, and land clearing costs. They cannot both expense and capitalize the costs. If the Jaworskis did not expense all of their liming, fertilizing, and land clearing costs, they could have used the unexpensed costs to reduce their 1978 capital gain. The Jaworskis, however, had to prove their unexpensed costs. They failed to do so.

The Court of Appeals did not decide any of the remaining issues.

The Court of Appeals affirmed the judgment of the Circuit Court for Marathon County.

The taxpayers have not appealed this decision.

**Marie L. Menacher vs. Wisconsin Department of Revenue** (Wisconsin Tax Appeals Commission, August 21, 1984). The only issue in this case is

the imposition of interest on unpaid taxes.

On July 25, 1978, the taxpayer received a cash separation benefit of \$694.53 from the Wisconsin Department of Employee Trust Funds, State Teachers Retirement Bureau. Of this amount, \$657.16 was includable as income and subject to Wisconsin income tax. The taxpayer did not report this \$657.16 distribution on her 1978 Wisconsin individual income tax return.

The department issued an income tax assessment dated October 25, 1982 against the taxpayer, imposing an income tax on this distribution. The total amount of additional income tax due was \$53.00, plus regular interest of \$23.54, for a total assessment of \$76.54.

The Commission concluded that the imposition of interest on unpaid taxes, per s. 71.09(5)(a), Wis. Stats., is mandatory and the Commission does not have the jurisdiction or authority to waive its imposition.

The taxpayer has not appealed this decision.

**Edwin J. Puissant, Jr. vs. Wisconsin Department of Revenue** (Wisconsin Tax Appeals Commission, July 5, 1984). The issue for the Commission to determine is whether the taxpayer's business expenses claimed in 1978 and 1979 are allowable deductions as follows: (A) whether living expenses incurred by him in 1978 and 1979 qualify for deduction under Section 162, IRC, as "away from home" expenses or whether he is an itinerant whose tax home coincided with his temporary job sites, (B) whether union dues are deductible as a business expense if the standard deduction is claimed and (C) whether interest and depreciation on a mobile home used as a personal residence are deductible as a business expense if the standard deduction is claimed.

The taxpayer contends that his tax home is Luxemburg, Wisconsin, and that he is on temporary assignment to other job sites. Thus he is entitled to deductions for necessary travel expenses and reasonable expenses for meals and lodging. The department contends that the employee business deductions are not allowable because each place the taxpayer worked became his main place of business and his tax home.

The taxpayer filed Wisconsin income tax returns for the years 1978 and 1979, reporting income earned as a boiler-maker as Wisconsin taxable income. He reported net taxable income in 1978 of \$12,543 and deducted business expenses of \$11,667. In 1979, he reported net taxable income of \$9,979 and deducted business expenses of \$13,026. The department disallowed these expenses in full.

In 1978, the taxpayer claimed union dues of \$725.87 as a business expense; he did not list his deductions as itemized deductions. The remainder of the business expenses (or \$10,941.13) are composed of expenses for meals, rent, telephone, utilities, motels, and mileage incurred at various temporary job sites in 1978.

The expenses claimed for 1979 are for the same items identified as expenses in 1978. The taxpayer also claimed interest and depreciation on a mobile home used as a personal residence as an additional business expense in 1979. The standard deduction was also claimed in 1979.

In 1974 or 1975, the taxpayer became a boiler-maker and described his work locations as "traveling the countryside". He secured jobs through his union located in Kansas City, Kansas. He had no control over his job locations and did not know in advance where he would be sent.

In 1978, the taxpayer worked for Grove Tank and Manufacturing and lived in New York for five months. The remainder of the year he lived in Texas and worked for Brown-Minneapolis Tank. Expenses for motels, rent, utilities, and telephone were for living expenses incurred at these temporary job sites. He resided in motel rooms or in a mobile home he owned and towed to his job sites. Meal expenses in 1978 were calculated by multiplying 48 weeks by 7 days by a cost of \$12 per day. Business mileage was calculated on the basis of local mileage for daily commuting and long distance travel between Wisconsin and his job sites in Texas or New York.

In 1979, the taxpayer worked in Tulsa, Oklahoma for 11 weeks; La-Porte, Texas for 24 weeks; and Bay City, Texas for 16 weeks. Living expenses, again, included motels and expenses for his mobile home. His wife resided with him "some of the



time" and spent the remainder living with her parents in Green Bay. Meal expenses were calculated by multiplying 358 days by \$14 a day. In 1979, interest and depreciation were claimed on the mobile home as business expenses. He testified he did not return to Wisconsin at any time in 1979.

The Commission ruled that the taxpayer was an itinerant worker who was not "away from his tax home" in Wisconsin while working at various job sites in Texas, New York, and Oklahoma. He acquired a tax home in each of his temporary job locations, and his living expenses and commuting expenses were personal expenses not deductible under Section 262 of the Code.

In addition, union dues, interest expenses, or depreciation on nonbusiness assets are not deductible in arriving at "adjusted gross income", but are only deductible as itemized deductions. Because the taxpayer elected the standard deduction in each of the years in question, these deductions are properly disallowed.

The taxpayer has not appealed this decision.

## **CORPORATION FRANCHISE/INCOME TAXES**

**Wisconsin Department of Revenue vs. Allen-Bradley Company** (Circuit Court of Milwaukee County, September 13, 1984). This matter is before the Court on review of a Decision and Order of the Wisconsin Tax Appeals Commission, which concluded that Allen-Bradley Company properly claimed a worthless stock loss deduction on its corporate income tax return for its fiscal year ending November 30, 1974.

In November 1969, Allen-Bradley purchased a majority of the outstanding common stock of MOS Technology, Inc. (MOS), increasing its holdings to 81.4% by December 1971. Additionally, it loaned money to MOS. From its inception through March 31, 1974, MOS experienced severe financial difficulties. Allen-Bradley was its sole available source of financing.

In 1973 and 1974, Allen-Bradley attempted to sell its interest in MOS without success. On October 9, 1974, a meeting was arranged between Allen-Bradley and National Cash Reg-

ister Company, which expressed a tentative interest in MOS. Negotiations broke off when it became apparent that any offer would result in only repayment of a small fraction of Allen-Bradley's outstanding loans and receipt of nothing for its stock.

On October 16, 1974, Allen-Bradley advised MOS that it would provide no further financing. At this time, one of its directors proposed that the assets and liabilities of MOS, excluding its debt to Allen-Bradley, might be sold to MOS minority shareholders. On October 30, 1974, the Allen-Bradley Board of Directors resolved to vote its shares in favor of the sale of MOS assets. Further, the Board of Directors passed a resolution declaring the shares it held in MOS to be worthless. On November 20, 1974, the Allen-Bradley Board of Directors voted to inform MOS that unless an offer to purchase the assets of the corporation were received by January 1, 1975, Allen-Bradley would unilaterally liquidate MOS.

On January 31, 1975, the assets of MOS were sold to PJM Technology, Inc., a corporation formed by the minority shareholders.

On its tax returns for the fiscal year ending November 30, 1974, Allen-Bradley claimed a worthless stock deduction for its MOS holdings. The department determined that the MOS stock became worthless during the fiscal year ending November 30, 1975.

The question presented for the Court is whether the facts as found by the Commission are sufficient to conclude there were "closed and completed transactions" which were "fixed by identifiable events" occurring in fiscal year 1974, within the meaning of the law. The Court concluded that the Order of the Commission is supported by substantial evidence and correctly applies the law.

The department has not appealed this decision.

**NCR Corporation vs. Wisconsin Department of Revenue** (Circuit Court of Dane County, August 16, 1984). The issue before the Court is whether the taxpayer was entitled to a deduction for federal income taxes paid for the years 1975 through 1980 under the provisions of s. 71.04(3), Wis. Stats.

Prior to 1975, s. 71.04(3), Wis. Stats., permitted corporations required to

file Wisconsin franchise tax returns a deduction for federal income taxes paid within the year covered by the income tax return. Section 71.04(3a) limited that deduction to 10% of the taxpayer's net income for that year.

In 1975, the Wisconsin Legislature repealed s. 71.04(3a). In the same year, the Legislature amended s. 71.04(3) to delete the reference to federal income taxes. However, s. 71.02(1)(c), Wis. Stats., which made reference to the basis on which federal income taxes were to be deducted and s. 71.11(8)(b) which incorporated the rules set forth in s. 71.02(1)(c), were left unchanged.

It is the taxpayer's contention that these statute sections, when read in harmony, unambiguously allow for a full corporate deduction of federal income taxes. It is the department's contention and the finding of the Tax Appeals Commission that s. 71.04(3) (1975) is ambiguous and that the Court may, therefore, look to legislative intent in interpreting it, that intention having been to eliminate, in its entirety, the corporate deduction for federal income taxes paid. The Commission also concluded that even if s. 71.04(3) was not ambiguous, giving it the meaning proposed by the taxpayer, would lead to an absurd and unreasonable result which justified construing it contrary to its plain meaning. (See WTB #37 for a summary of the Tax Appeals Commission's decision.)

The Circuit Court agreed with the findings of the Commission that it was the objective of the Legislature in 1975 not merely to repeal the 10% limitation for deduction of federal income taxes, but to eliminate entirely the federal income tax deduction and thereby to generate additional revenue for the state general fund. The Court, therefore, finds that s. 71.04(3) does not include a deduction for federal income taxes for the years 1975 through 1980.

The Circuit Court found that to give s. 71.04(3) the meaning advocated by the taxpayer would lead to an absurd and unreasonable result. Section 71.04(3) does not allow the taxpayer a deduction for federal income taxes paid for the years 1975 through 1980. The decision of the Commission is confirmed.

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

## SALES/USE TAXES

### Specialty Associates, Inc. vs. Wisconsin Department of Revenue

(Wisconsin Tax Appeals Commission, July 31, 1984). During the period under review, the taxpayer, a Wisconsin corporation with its principal place of business in West Allis, Wisconsin, was a roofing contractor doing real estate improvements. The issue for the Commission to determine is whether or not the taxpayer used construction materials to make real estate improvements for certain tax-exempt entities, and is thus liable for the use tax under s. 77.53(1), Wis. Stats. The department contends that the taxpayer cannot meet its burden to show that it purchased and sold building materials to specific tax-exempt entities. It is the department's position that the taxpayer used these building materials to make real estate improvements, and that the user of these materials is responsible for the sales and use tax on the materials.

Specialty Associates, Inc. contends that it was acting simply and solely as an agent for SAI Wholesale Distributors, Inc., which is a separate Wisconsin corporation formed solely for the purpose of selling wholesale roofing materials. In any contract with a tax-exempt entity, Specialty Associates was performing two separate contracts: one by Specialty Associates for the purpose of installing materials, and two as an agent for SAI as a retailer selling and delivering the materials directly to the tax-exempt entity.

The taxpayer entered into contracts with tax-exempt and non-tax-exempt entities for installing roofing materi-

als to real property. The contract may or may not have included specifications. If the contract was with a tax-exempt entity, Specialty Associates would request its tax number. The roofing materials were purchased from SAI, Inc. and other suppliers without payment of the sales and use tax by the taxpayer's use of the tax-exempt entity's number for jobs involving the tax-exempt entity. If the materials were purchased for a non-tax-exempt entity, the tax was paid in most cases. The taxpayer billed the entity for the entire job. Specialty Associates received 100% of the funds for the construction work. The taxpayer then paid its suppliers.

Specialty Associates used its name and credit to purchase the roofing materials. The taxpayer installed the materials with its employees. The taxpayer was not selling tangible personal property but rather real estate improvements using tangible personal property.

The Commission held that under s. 77.51(18), Wis. Stats., Specialty Associates was a contractor who purchased and was the consumer of tangible personal property used by it in real property construction activities and the use tax applies to the sale of materials used by it. Under s. 77.51(18), Wis. Stats., the taxpayer did not issue proper exemption certificates because it had such reason to believe it would sell the materials to customers for whom it would perform real property construction activities involving the use of the materials. The taxpayer is liable for the use tax under s. 77.53(1), Wis. Stats., on the purchase of the materials

which it sold to and installed for real estate improvements to tax-exempt entities.

The taxpayer has not appealed this decision.

## CIGARETTE TAX

### George R. Elliott vs. Wisconsin Department of Revenue

(Circuit Court of Dane County, September 6, 1984). In response to a newspaper ad, George Elliott ordered 63 cartons of cigarettes from Tobacco Land, USA. Because Tobacco Land does not maintain an office in Wisconsin, it did not collect Wisconsin excise taxes from Mr. Elliott on his purchase. Instead, Tobacco Land reported the sale of tax-free cigarettes to the Wisconsin Department of Revenue as required by 15 U.S.C. ss. 375-376. Based on this report, the department advised Mr. Elliott that he owed \$100.80 in Wisconsin excise taxes. Mr. Elliott promptly paid the amount due. The department then notified him that a penalty of \$25 per carton had been assessed under s. 139.33(3), Wis. Stats., for his failure to pay the excise taxes within 15 days of his receiving the cigarettes. Mr. Elliott challenged the penalty assessment before the Wisconsin Tax Appeals Commission, which affirmed the assessment. (See WTB #37 for a summary of the Tax Appeals Commission's decision.)

The Circuit Court affirmed the decision of the Wisconsin Tax Appeals Commission.

The taxpayer has not appealed this decision.

## 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.)*

### Individual Income Taxes

1. The Determination of "Federal Adjusted Gross Income" for Computing Taxable Unemployment Com-

pensation, the Earned Income Credit, and the Child and Dependent Care Credit for Wisconsin

2. Minimum Tax Limited by Tax Benefit Rule
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## INDIVIDUAL INCOME TAXES

### 1. The Determination of "Federal Adjusted Gross Income" for Computing Taxable Unemployment Compensation, the Earned Income Credit, and the Child and Dependent Care Credit for Wisconsin

**Facts:** The computation of taxable unemployment compensation, the earned income credit, and the child and dependent care credit for Wisconsin is based on federal adjusted gross income.

Taxable unemployment compensation is computed by adding federal adjusted gross income (other than the married couples' deduction) and the unemployment benefits received. This sum is compared with a base amount (\$18,000 for a joint return, \$12,000 for a single person, and zero for a married person filing separately). If this sum exceeds the base amount, either one-half of the excess or the amount of the unemployment benefits, whichever is lower, is included in gross income.

The Wisconsin earned income credit is 30% of the federal credit. The federal credit is 10% of earned income (e.g., wages, salaries, tips) up to \$6,000, or \$500, whichever is lower. When federal adjusted gross income exceeds \$6,000, the maximum available credit (\$500) decreases by 12.5% of the amount of federal adjusted gross income over \$6,000. If federal adjusted gross income is \$10,000 or more, no credit is available.

The Wisconsin child and dependent care credit is 30% of the federal credit. The federal credit is based on employment related expenses of up to \$2,400 for one dependent and \$4,800 for two or more dependents. The credit is a varying percentage of qualifying expenses, depending on federal adjusted gross income. If total federal adjusted gross income is \$10,000 or less, the credit is 30% of the expenses. As a person's income increases, the percentage of credit available decreases. For federal adjusted gross income above \$28,000, the credit is 20% of eligible expenses.

For Wisconsin purposes, federal adjusted gross income is not always the same as the amount reported on the federal return. There are several reasons why differences may occur.

A. For Wisconsin, federal adjusted gross income does not include state tax refunds which were reported as income on the federal return. Since taxes are not allowed as itemized deductions for Wisconsin, a refund of state income taxes which is taxable income for federal purposes is not includable in Wisconsin income.

B. For Wisconsin for the taxable year 1984, income is determined based on the Internal Revenue Code in effect on December 31, 1983. Therefore, federal laws enacted during 1984, including the Tax Reform Act of 1984, do not apply for Wisconsin.

C. Two provisions of the Internal Revenue Code in effect on December 31, 1983 also do not apply for Wisconsin for the 1984 taxable year. These provisions are (1) the foreign earned income exclusion and foreign housing cost exclu-

sion, and (2) the incentive stock option provisions of Section 422A of the Internal Revenue Code.

Federal law permits the exclusion of up to \$80,000 of foreign earned income and the exclusion of foreign housing costs for United States citizens working abroad. Wisconsin law provides a foreign earned income exclusion of \$15,000 (\$20,000 for employees of United States charitable organizations) for United States citizens who are bona fide residents of foreign countries or who are present in foreign countries for a specified period of time.

Federal law provides that there is no tax consequence when an incentive stock option is granted or exercised. The employee is taxed at the capital gains rates when the stock is sold. For Wisconsin, income is generally recognized either when the option is granted or when it is exercised, depending on the circumstances.

**Question:** Since the federal adjusted gross income reportable for Wisconsin may differ from the amount reportable for federal purposes, must the taxpayer recompute federal adjusted gross income before computing taxable unemployment compensation, or the allowable earned income credit or child and dependent care credit for Wisconsin?

**Answer:** The taxpayer may recompute federal adjusted gross income before computing the taxable unemployment compensation for Wisconsin, or the allowable Wisconsin earned income credit or child and dependent care credit. However, in many cases the recomputation of federal adjusted gross income will not alter the amount of taxable unemployment compensation. Likewise, the change in the amount of earned income credit or child and dependent care credit may be zero or minimal. Following are several examples which show how to recompute federal adjusted gross income and the result.

#### A. Unemployment Compensation

**Example 1:** A husband and wife file a joint federal return for 1984 and report total income of \$26,000, which includes a state tax refund of \$800 but does not include the husband's unemployment compensation of \$5,000. They claim a \$450 deduction for a married couple when both work, but have no other adjustments to income.

**Federal Return** — The total amount of the husband's unemployment compensation is taxable, based on the following computation (references are to lines on the federal unemployment compensation worksheet):

( 3 )	Unemployment compensation received	\$ 5,000
( 4 )	Add: Federal income other than unemployment compensation	26,000
( 5 )	Total income and unemployment compensation	\$ 31,000
( 6 )	Subtract: Adjustments to income except married couples' deduction	-0-
( 7 )	Adjusted federal income and unemployment compensation	\$ 31,000
( 8 )	Subtract: Base amount for married filing a joint return	(18,000)
( 9 )	Excess over base amount	\$ 13,000
(10)	One-half of excess over base amount	\$ 6,500
(11)	Taxable unemployment compensation (lesser of line 3 or line 10)	\$ 5,000

**Wisconsin Return** — The total amount of the husband's unemployment compensation is taxable, based on the following computation:

(1) Amount from line 7 of federal unemployment compensation worksheet	\$ 31,000
(2) Subtract: State tax refund	<u>(800)</u>
(3) Adjusted income and unemployment compensation	\$ 30,200
(4) Subtract: Base amount for married filing a joint return	<u>(18,000)</u>
(5) Excess over base amount	<u>\$ 12,200</u>
(6) One-half of excess over base amount	\$ 6,100
(7) Amount from line 3 of federal unemployment compensation worksheet	\$ 5,000
(8) Taxable unemployment compensation (lesser of line 6 or line 7)	<u>\$ 5,000</u>

As a result of recomputing federal adjusted gross income, there is no change in the amount of taxable unemployment compensation.

**Example 2:** A single person receives wages of \$12,400, a state tax refund of \$600 and unemployment compensation of \$1,000 during 1984.

**Federal Return** — The entire \$1,000 of unemployment compensation is taxable, based on the following computation:

(3) Unemployment compensation received	\$ 1,000
(4) Add: Federal income other than unemployment compensation	<u>13,000</u>
(5) Total income and unemployment compensation	\$ 14,000
(6) Subtract: Adjustments to income	<u>-0-</u>
(7) Adjusted federal income and unemployment compensation	\$ 14,000
(8) Subtract: Base amount for a single person	<u>(12,000)</u>
(9) Excess over base amount	<u>\$ 2,000</u>
(10) One-half of excess over base amount	\$ 1,000
(11) Taxable unemployment compensation (lesser of line 3 or line 10)	<u>\$ 1,000</u>

**Wisconsin Return** — Only \$700 of the person's unemployment compensation is taxable, based on the following computation:

(1) Amount from line 7 of federal unemployment compensation worksheet	\$ 14,000
(2) Subtract: State tax refund	<u>(600)</u>
(3) Adjusted income and unemployment compensation	\$ 13,400
(4) Subtract: Base amount for a single person	<u>(12,000)</u>
(5) Excess over base amount	<u>\$ 1,400</u>
(6) One-half of excess over base amount	\$ 700
(7) Amount from line 3 of federal unemployment compensation worksheet	\$ 1,000
(8) Taxable unemployment compensation (lesser of line 6 or line 7)	<u>\$ 700</u>

As a result of recomputing federal adjusted gross income there is a \$300 decrease in the amount of taxable unemployment compensation. Assuming the person claims the standard deduction for Wisconsin, the tax savings as a result of recomputing federal adjusted gross income is \$25.

#### B. Earned Income Credit

**Example 1:** A single person having one dependent and qualifying for federal head of household status has 1984

federal adjusted gross income of \$5,925, which consists of wages of \$5,800 and a state tax refund of \$125. The federal earned income credit is \$500. Based on this amount, the Wisconsin earned income credit is \$150 ( $\$500 \times 30\%$ ).

If the person recomputes federal adjusted gross income by subtracting the state tax refund, federal adjusted gross income is \$5,800 and the federal earned income credit is \$500. Based on this amount, the Wisconsin earned income credit is \$150 ( $\$500 \times 30\%$ ). As a result of recomputing federal adjusted gross income, there is no change in the Wisconsin earned income credit.

**Example 2:** A husband and wife with two dependents report joint federal adjusted gross income for 1984 of \$10,010 which includes a \$160 state tax refund. Because their federal adjusted gross income exceeds \$10,000, they are not eligible for a federal earned income credit.

If they recompute their federal adjusted gross income by subtracting the state tax refund, their federal adjusted gross income is \$9,850 and their federal earned income credit is \$22. Based on this amount, their Wisconsin earned income credit is \$6.60 ( $\$22 \times 30\%$ ). As a result of recomputing federal adjusted gross income, a Wisconsin earned income credit of \$6.60 is allowable. No amount of credit was allowable before the recomputation.

#### C. Child and Dependent Care Credit

**Example 1:** A single person who paid \$2,000 for the care of one dependent reports 1984 federal adjusted gross income of \$14,050, which consists of wages of \$13,830, interest of \$45, and a state tax refund of \$175. Based on federal adjusted gross income of \$14,050, the person is entitled to a federal child and dependent care credit of \$540 ( $\$2,000 \times 27\%$ ). The person's Wisconsin child and dependent care credit is \$162 ( $\$540 \times 30\%$ ).

If the person recomputes federal adjusted gross income by removing the state tax refund, federal adjusted gross income is \$13,875. The federal child and dependent credit is \$560 ( $\$2,000 \times 28\%$ ). The Wisconsin child and dependent care credit is \$168 ( $\$560 \times 30\%$ ). As a result of recomputing federal adjusted gross income, an additional \$6 of Wisconsin child and dependent care credit is allowable.

**Example 2:** A husband and wife paid \$6,000 during 1984 for the care of their two children. They file a joint federal return for 1984 and report the husband's wages of \$40,000, the wife's wages of \$20,000, a state tax refund of \$800, and a rental loss of \$7,000. During 1984 the husband exercised incentive stock options, which resulted in the recognition of \$5,000 of taxable income for Wisconsin purposes. Based on federal adjusted gross income of \$53,800, the couple's federal child and dependent care credit is \$960 ( $\$4,800 \times 20\%$ ). Their Wisconsin child and dependent care credit is \$288 ( $\$960 \times 30\%$ ).

If they recompute their federal adjusted gross income by adding the income from exercising incentive stock options and subtracting the state tax refund, their federal adjusted gross income is \$58,000. Their federal child and dependent care credit is \$960 ( $\$4,800 \times 20\%$ ). Their Wisconsin child and dependent care credit is \$288 ( $\$960 \times 30\%$ ). As a result of recomputing federal adjusted gross income, there is no change in the Wisconsin child and dependent care credit.

## 2. Minimum Tax Limited By Tax Benefit Rule

**Facts:** Section 71.60(2), Wis. Stats., imposes a minimum tax on individuals, trusts and estates on the amount by which the sum of their tax preference items exceeds \$10,000. Tax preference items are adjusted itemized deductions, the capital gain deduction and the following other tax preference items defined in the Internal Revenue Code: accelerated depreciation on real property, accelerated depreciation on leased personal property, circulation and research experimental expenditures, depletion, intangible drilling costs and accelerated cost recovery deductions.

There are situations in which a person derives no tax benefit from a tax preference item. For example, if an individual has no adjusted gross income after deducting accelerated depreciation on real property, and has itemized deductions which are not used, no tax benefit has been derived from the accelerated depreciation to the extent of the unused itemized deductions. As a second example, if an individual has both adjusted itemized deductions and a capital gain deduction, one dollar of capital gain preference will generate more than one dollar of total preferences and hence, may create a situation where claiming a preference deduction may actually result in an increase in the person's tax liability. This is because the determination of adjusted itemized deductions is based in part on adjusted gross income which has been reduced by the capital gain deduction. (To illustrate, assume a person has gross income of \$100,000, a capital gain deduction of \$60,000, adjusted gross income of \$40,000 and itemized deductions of \$40,000. The \$60,000 capital gain deduction will generate total tax preferences of \$76,000, the \$60,000 capital gain deduction plus adjusted itemized deductions of \$16,000.)

**Question:** Does the tax benefit rule limit the application of minimum tax to preference deductions that provide a tax benefit to the taxpayer?

**Answer:** Yes, the minimum tax may be reduced or eliminated if a tax benefit has not been derived from the tax preference items.

A taxpayer must figure his or her "recomputed income" to determine the extent to which the tax preference items reduce taxable income and thereby provide a tax benefit. "Recomputed income" is gross income less all nonpreference deductions, other than those itemized deductions that exceed 100% of adjusted gross income computed without regard to preference deductions. Specifically, recomputed income is the following:

Gross Income	
Less: Nonpreference deductions for Wisconsin adjusted gross income (including the nonpreference net operating loss carryforward)	
Less: Medical, casualty and community development finance authority (CDFA) itemized deductions	
Less: Other itemized deductions (interest, charitable and political contributions and misc. deductions) to the extent of 60% of Wisconsin adjusted gross income computed without regard to preference deductions	
Equals: Recomputed income	

Recomputed income represents the maximum limit on the tax benefit provided by the tax preference items. Minimum tax is computed on the lesser of the recomputed income or the sum of the tax preferences, less the \$10,000 base.

For a husband and wife determining recomputed income, itemized deductions are prorated in the same manner that they are prorated in determining adjusted itemized deductions (see the instructions to Schedule MT, line 1).

**Example:** Assume an individual has the following gross income and deductions:

Gross income	\$ 260,000
Capital gain deduction	(30,000)
Business deductions (all nonpreference)	(130,000)
Adjusted gross income	\$ 100,000
Medical deduction	(10,000)
Other itemized deductions	(150,000)
Net taxable income (loss)	<u>\$ (60,000)</u>

The individual's tax preferences total \$70,000 (the capital gain deduction of \$30,000 plus adjusted itemized deductions of \$40,000).

The individual's first step is to calculate his or her recomputed income to determine whether a tax benefit was derived from the tax preference items:

Gross income	\$ 260,000
Nonpreference deductions for AGI	(130,000)
Medical, casualty and CDFAs deductions	(10,000)
Other itemized deductions to the extent of 60% of WI AGI computed without regard to preference deductions (60% × (AGI of \$100,000 + preference deductions of \$30,000 added back))	(78,000)
Recomputed income	<u>\$ 42,000</u>

The individual's second step is to compare recomputed income with the total tax preferences (these were \$70,000). In this example the recomputed income is less, therefore, \$42,000 is the maximum amount of tax preference items that should be reported on Schedule MT (the individual should attach a schedule to his or her tax return showing how the \$42,000 is computed, and report the amount on 1984 Schedule MT, line 8).

The individual's last step is to compute the minimum tax as follows:

Total tax preference items	\$ 42,000
Less: \$10,000	(10,000)
Subtotal	\$ 32,000
1984 rate	× 5%
Minimum tax	<u>\$ 1,600</u>

## 3. Minimum Tax When Taxpayer Has a Net Operating Loss

**Facts:** Section 71.60(2), Wis. Stats., imposes a minimum tax on individuals, trusts and estates on the amount by which the sum of their tax preference items exceeds \$10,000. Tax preference items include adjusted itemized deductions, the capital gain deduction and the following other tax preference items defined in the Internal Revenue Code: accelerated depreciation on real property, accelerated depreciation on leased personal property, circulation and research experimental expenditures, depletion, intangible drilling costs, and accelerated cost recovery deductions.

When tax preference deductions are claimed, they may result in a Wisconsin net operating loss as defined in s. 71.02(2)(m), Wis. Stats. In a net operating loss situation the Wisconsin minimum tax may be limited in the loss year to tax on the tax preference items that yield a tax benefit (see Tax Release #2 "Minimum Tax Limited by Tax Benefit Rule").

Under s. 71.05(1)(d), Wis. Stats., a net operating loss may be carried forward for up to 5 years. The net operating loss carryforward may be composed of both tax preference and nonpreference deductions. When the net operating loss carryforward is used, any tax preferences included in the carryforward may provide a tax benefit in the year the carryforward is deducted.

**Question 1:** Can the Wisconsin minimum tax be imposed in the year of a net operating loss, and if so, how is it computed?

**Question 2:** When a net operating loss carryforward includes tax preference items, can it result in minimum tax in the year it is deducted? If so, how is the minimum tax computed?

**Answer to Question 1:** Yes, Wisconsin minimum tax can be imposed in the year of a net operating loss. However, minimum tax is limited by the tax benefit rule to tax on preference deductions used to reduce taxable income to zero, and not below zero. See Tax Release #2 "Minimum Tax Limited by Tax Benefit Rule".

**Example:** Assume an individual has the following gross income and deductions:

Gross income (including \$5,000 of non-business income)	\$ 120,000
Accelerated depreciation on real estate (business)	(80,000)
Other business deductions (all nonpreference)	(70,000)
Adjusted gross income	\$ (30,000)
Itemized deductions (all interest)	(10,000)
Net taxable income (loss)	<u>\$ (40,000)</u>

The individual's tax preferences total \$80,000 (accelerated depreciation on real estate). The individual's net operating loss is \$35,000 (loss of \$40,000 plus nonbusiness deductions in excess of nonbusiness income of \$5,000).

The individual will calculate his or her minimum tax as follows:

Gross income	\$ 120,000
Nonpreference deductions for AGI	(70,000)
Itemized deductions to 60% of WI AGI computed without regard to preference deductions ( $60\% \times (-30,000 + 80,000) = 30,000$ , limited to actual deductions)	(10,000)
Recomputed income	<u>\$ 40,000</u>
Lesser of total tax preferences or recomputed income	\$ 40,000
Less: \$10,000	(10,000)
Subtotal	\$ 30,000
1984 rate	$\times 5\%$
Minimum tax	<u>\$ 1,500</u>

**Answer to Question 2:** Yes, if a net operating loss carryforward deduction includes tax preference items it can result in a Wisconsin minimum tax in the year the deduction is claimed. This will happen when the tax preference items do not produce a tax benefit in the year of the loss but do produce a tax benefit in the carryforward year.

In the loss year the taxpayer must determine what portion of his or her net operating loss consists of tax preferences. The portion of the net operating loss that consists of tax preferences is calculated as follows:

Total tax preferences for loss year

Less:	\$10,000 base
Less:	Tax preferences included in total above which were subject to the minimum tax in previous years (tax preferences in excess of the \$10,000 base)
Less:	Capital gain deduction included in total above
Less:	Nonbusiness tax preferences and adjusted itemized deductions included in the total above, if the preferences did not become part of the net operating loss
Equals:	Portion of net operating loss deduction that consists of tax preferences (limited to actual net operating loss)

When the portion of the net operating loss that consists of tax preferences is deducted in the carryforward years, the amount used should be added to other tax preferences for the carryforward year on Schedule MT (for 1984, enter on line 11 of Schedule MT).

Note that the earliest net operating loss carryforwards must be used first. Also, the portion of the net operating loss carryforwards *not* due to tax preferences may be used first.

**Example:** Assume an individual has the following gross income, deductions, and net operating loss:

	Year 1	Year 2
Gross income (including \$20,000 of nonbusiness income)	\$ 100,000	\$ 100,000
Accelerated depreciation on real estate	(20,000)	(10,000)
Depletion	(30,000)	
Capital gain deduction	(20,000)	
Other business deductions	(50,000)	(40,000)
Net operating loss deduction	-0-	(20,000)
Adjusted gross income	\$ (20,000)	\$ 30,000
Medical deduction	(10,000)	
Other itemized deductions	(30,000)	(20,000)
Net taxable income (loss)	<u>\$ (60,000)</u>	<u>\$ 10,000</u>
Net taxable income (loss)	\$ (60,000)	
Add back capital gain deduction	20,000	
Add back nonbusiness deductions in excess of nonbusiness income	<u>20,000</u>	
Net operating loss	<u>\$ (20,000)</u>	

The individual's tax preferences in Year 1 are \$70,000 (accelerated depreciation on real estate \$20,000, plus depletion \$30,000, plus capital gain deduction \$20,000). Minimum tax for Year 1 is computed as follows (see Tax Release #2 "Minimum Tax Limited by Tax Benefit Rule"):

Gross income	\$ 100,000
Nonpreference deductions for AGI	(50,000)
Medical deduction	(10,000)
Other itemized deductions to 60% of WI AGI computed without regard to tax preferences ( $60\% \times (-20,000 + 70,000)$ )	(30,000)
Recomputed income	<u>\$ 10,000</u>
Lesser of total tax preferences or recomputed income	\$ 10,000
Less: 10,000	(10,000)
Subtotal	\$ -0-
1984 rate	$\times 5\%$
Minimum tax	<u>\$ -0-</u>

The portion of the individual's net operating loss carryforward to Year 2 that consists of tax preferences is calculated as follows:

Total tax preferences for Year 1	\$ 70,000
Less: \$10,000 base	(10,000)
Less: Tax preferences subject to minimum tax in Year 1	(-0-)
Less: Capital gain deduction	(20,000)
Portion of net operating loss that consists of tax preferences (limited to actual net operating loss)	<u>\$ 20,000</u>

Thus, the entire net operating loss is considered due to tax preferences and may generate minimum tax in future carryforward years.

The individual's tax preferences in Year 2 are \$32,000 (accelerated depreciation on real estate \$10,000, tax preferences in net operating loss deduction \$20,000, plus adjusted itemized deductions \$2,000). Minimum tax for Year 2 is computed as follows:

Gross income	\$ 100,000
Nonpreference deductions for AGI	(40,000)
Other itemized deductions to 60% of WI AGI computed without regard to preference deductions ( $60\% \times (30,000 + 30,000)$ , limited to actual itemized deductions)	(20,000)
Recomputed income	<u>\$ 40,000</u>
Lesser of total tax preferences or recomputed income	\$ 32,000
Less: \$10,000 (does not apply to the net operating loss tax preferences carried forward)	(10,000)
Subtotal	\$ 22,000
1984 rate	$\times 5\%$
Minimum tax	<u>\$ 1,100</u>

#### 4. Wisconsin Net Operating Loss

**Introduction:** Section 71.02(2)(m), Wis. Stats., provides that a "Wisconsin net operating loss" of persons other than corporations for the 1965 taxable year and thereafter means a "federal net operating loss" adjusted by the mod-

ifications prescribed in sections 71.05(1) and (4), Wis. Stats. Section 71.02(2)(l), Wis. Stats., provides that a "federal net operating loss" of persons other than corporations means a net operating loss as determined under the Internal Revenue Code. For Wisconsin tax purposes, the Internal Revenue Code means the federal Internal Revenue Code as defined under section 71.02(2), Wis. Stats. Therefore, a Wisconsin net operating loss is a federal net operating loss adjusted by the modifications and differences between Wisconsin and federal law prescribed under the statutes.

**Computation of Federal Net Operating Loss:** In general, a federal net operating loss is equal to gross income less deductions, subject to certain adjustments explained as follows:

- Personal exemptions are not deductible.
- The net operating loss carryovers and carrybacks from other taxable years are not deductible.
- The long-term capital gain deduction is not allowable.
- Nonbusiness capital losses are only deductible to the extent of nonbusiness capital gains.
- Nonbusiness deductions are allowable only to the extent of nonbusiness income, including any nonbusiness capital gains that remain after deducting nonbusiness capital losses.
- Business capital losses are only deductible to the extent of business capital gains plus any nonbusiness capital gains that remain after deducting nonbusiness capital losses and other nonbusiness deductions.

For more information on how to compute a federal net operating loss, refer to federal Publication 536, *Net Operating Losses and the At-Risk Limits*.

**Adjustments Required To Compute A Wisconsin Net Operating Loss:** Certain adjustments must be made to a federal net operating loss in order to compute a Wisconsin net operating loss. A federal net operating loss must be (a) reduced by the addition modifications prescribed under sections 71.05(1) and (4), Wis. Stats., (b) increased by the subtraction modifications prescribed under sections 71.05(1) and (4), Wis. Stats., and (c) adjusted by the differences between Wisconsin and federal law that exist because of Wisconsin's definition of the Internal Revenue Code. The modifications prescribed under sections 71.05(1) and (4), Wis. Stats., and differences between Wisconsin and federal law defined under section 71.02(2), Wis. Stats., are explained below.

##### A. Addition Modifications

- Interest on state and municipal bonds and volunteer fire department and mass transit obligations, less related expenses, excluded by reason of section 103 of the Internal Revenue Code. (s. 71.05(1)(a)1, Wis. Stats.)
- Any amounts deducted under section 1202 of the Internal Revenue Code (relating to the deduction for capital gains) for taxable years prior to 1982. For taxable year 1982, two-thirds of any amounts deducted under section 1202 of the Internal Revenue Code in effect on December 31, 1980. For taxable year 1983, one-third of any amounts deducted under section 1202 of the Internal Revenue Code in effect on December 31, 1980. For taxable year 1984 and thereafter, none of the



amounts deducted under section 1202 of the Internal Revenue Code in effect on December 31, 1980. (s. 71.05(1)(a)2, Wis. Stats.) Note: Capital gains are taken into account at 100 percent in computing a federal net operating loss so that it should generally not be necessary to adjust a federal net operating loss by this modification in computing the Wisconsin net operating loss.

3. Losses of nonresident individuals not allocable or apportionable to Wisconsin under s. 71.07, Wis. Stats. (s. 71.05(1)(a)3, Wis. Stats.)

**Example:** A nonresident of Wisconsin incurred a Wisconsin farm loss of \$(3,000) and an Illinois business loss of \$(5,000) in 1984. These were the nonresident's only sources of income (loss) in 1984 so that his federal net operating loss was \$(8,000). Section 71.07(1), Wis. Stats., provides that all income or loss of nonresident individuals derived from business follows the situs of the business from which derived. Therefore, an add modification must be made to the federal net operating loss for the Illinois business loss not allocable to Wisconsin in computing the Wisconsin net operating loss. Thus, the Wisconsin net operating loss is \$(3,000).

4. Any amount deducted as a capital loss carryover from any taxable year prior to the 1965 taxable year. (s. 71.05(1)(a)4, Wis. Stats.)

5. Gain on the sale or exchange of a principal residence excluded under section 1034(a) of the Internal Revenue Code, if the new residence referred to therein is located outside Wisconsin (1981 taxable years and prior). (s. 71.05(1)(a)5, Wis. Stats.)

6. The Wisconsin taxable portion of a capital gain on the involuntary conversion of Wisconsin property by nonresident individuals excluded under section 1033 of the Internal Revenue Code if the replacement property is located outside Wisconsin. (s. 71.05(1)(a)6, Wis. Stats.)

7. Moving expenses incurred to move from Wisconsin. (s. 71.05(1)(a)7, Wis. Stats.)

8. The amount of any lump sum distribution from an employee benefit plan taxable under section 402(e)(1) of the Internal Revenue Code. (s. 71.05(1)(a)8, Wis. Stats.)

9. Any amount deducted as a capital loss carryover from any taxable year prior to 1975 if the capital asset which generated the loss had a situs outside of Wisconsin. (s. 71.05(1)(a)9, Wis. Stats.)

**Example:** A Wisconsin resident sold Illinois investment property in 1974 and incurred a substantial net long-term capital loss which is carried forward and offset against all 1984 capital gains for federal tax purposes. In computing the 1984 federal net operating loss, capital gains and losses are taken into account at 100 percent except that capital losses may not exceed capital gains. Since the capital asset which generated the loss in 1974 had a situs outside of Wisconsin, the Wisconsin net operating loss is computed by reducing the federal net operating loss by the amount of capital loss carried forward and offset against 1984 federal capital gains.

10. Any amount received in taxable year 1979 or thereafter by a Wisconsin resident shareholder as a proportionate share of the earnings and profits of a

tax-option corporation, which was accumulated prior to the beginning of its 1979 taxable year and not considered a dividend when received under section 1375(d)(1) of the Internal Revenue Code. (s. 71.05(1)(a)10, Wis. Stats.)

11. Interest income on all-savers certificates excluded from federal taxable income by reason of section 128 of the Internal Revenue Code. (s. 71.05(1)(a)11, Wis. Stats.)

12. Any amount excluded under section 305(e) of the Internal Revenue Code (relating to dividends reinvested in stock of public utilities). (s. 71.05(1)(a)12, Wis. Stats.)

13. The Wisconsin taxable portion of a gain on the sale or exchange of capital assets with Wisconsin situs by a nonresident alien to the extent not included in federal adjusted gross income or federal taxable income (1979 taxable years and thereafter). (s. 71.05(1)(a)13, Wis. Stats.)

14. Any amount deducted as a charitable contribution under section 170(i) of the Internal Revenue Code by an individual who does not itemize deductions. (s. 71.05(1)(a)14, Wis. Stats.)

15. Wages paid to an entertainer or entertainment corporation unless the taxpayer complies with Wisconsin's reporting requirements under ss. 71.10(18)(am), 71.19(4)(b) and 71.20(23) and (24), Wis. Stats. (s. 71.05(1)(a)15, Wis. Stats.)

16. An amount equal to the amount of credit allowed for qualified research expenses and facilities under s. 71.09(12r) and (12rf), Wis. Stats. (s. 71.05(1)(a)16, Wis. Stats.)

17. Any amount deducted as a two-earner marital deduction under section 221 of the Internal Revenue Code. (s. 71.05(1)(a)17, Wis. Stats.)

18. Any amount excluded from adjusted gross income under section 641(c)(1) of the Internal Revenue Code (relating to gain on the sale of any property by a trust within 2 years of acquisition). (s. 71.05(1)(a)22, Wis. Stats.)

## B. Subtraction Modifications

1. Interest or dividend income on U.S. government obligations, less related expenses, which is by federal law exempt from taxation by Wisconsin. (s. 71.05(1)(b)1, Wis. Stats.)

2. Any amount included under section 668 of the Internal Revenue Code (relating to interest charges on accumulation distributions from foreign trusts). (s. 71.05(1)(b)2, Wis. Stats.)

3. Net income of nonresident individuals not allocable or apportionable to Wisconsin under s. 71.07, Wis. Stats. (s. 71.05(1)(b)3, Wis. Stats.)

**Example:** A nonresident of Wisconsin incurred a Wisconsin business loss of \$(10,000). The nonresident also had Iowa farm income of \$3,000 so that his federal net operating loss was \$(7,000). Section 71.07(1), Wis. Stats., provides that all income or loss of nonresident individuals derived from the operation of any farm follows the situs of the property from which derived.

Therefore, a subtraction modification must be made from the federal net operating loss for the lowa farm income not allocable to Wisconsin in computing the Wisconsin net operating loss. Thus, the Wisconsin net operating loss is \$(10,000).

4. Any other amount not subject to taxation under Chapter 71 of the Wisconsin Statutes, less any amount allocable thereto which has been deducted in the computation of federal taxable or adjusted gross income. (s. 71.05(1)(b)4, Wis. Stats.)

Example: A subtraction modification is allowed under this section of the statutes for income that is exempt from taxation under Chapter 71. Military pay, payments from certain employee retirement systems and civil service annuities may be exempt from taxation if certain statutory requirements are met.

5. Any interest received or accrued by prisoners of war during their imprisonment or during the year of their release on income which is exempt from taxation under section 112 of the Internal Revenue Code. (s. 71.05(1)(b)5, Wis. Stats.)

6. Any amount expended by an adoptive parent or a prospective adoptive parent for adoption costs, to the extent that this amount, when added to allowable medical deductions under section 213 of the Internal Revenue Code, exceeds 5 percent of the person's federal adjusted gross income. (The federal adjusted gross income limitation was 3 percent for the 1979 through 1982 taxable years). (s. 71.05(1)(b)7, Wis. Stats.)

7. Disability payments to persons under age 65 who retired on disability and who were permanently and totally disabled, to the extent these payments were excludable under section 105(d) of the Internal Revenue Code immediately prior to its repeal in 1983. (s. 71.05(1)(b)8, Wis. Stats.)

8. Social security and railroad retirement benefits to the extent included in federal adjusted gross income under sections 72(r) and 86 of the Internal Revenue Code (s. 71.05(1)(b)9, Wis. Stats.)

9. Sick pay benefits paid under the Railroad Retirement Insurance Act to the extent these payment were included in federal adjusted gross income under section 105(i) of the Internal Revenue Code (s. 71.05(1)(b)10, Wis. Stats.)

#### C. Addition or Subtraction Modifications, As Appropriate

1. Transitional adjustments and other adjustments reflecting differences between the federal and Wisconsin bases of assets per ss. 71.05(1)(c), (2), (4) and (5), Wis. Stats.

2. Distributive share of partnership modifications. (s. 71.05(1)(e), Wis. Stats.)

3. Any amounts included or excluded from federal adjusted gross income by reason of Subchapter R of the Internal Revenue Code (relating to proprietorships or partnerships electing to be taxed as corporations). (s. 71.05(1)(f)1, Wis. Stats.)

4. Any amount included or excluded from a shareholder's 1979 federal adjusted gross income which represents his or her proportionate share of a tax-op-

tion corporation's federal taxable income or loss for taxable year 1978. (s. 71.05(1)(f)2, Wis. Stats.)

5. A shareholder's proportionate share of the difference between a tax-option corporation's federal taxable income or loss and Wisconsin net income or loss (1979 taxable year and thereafter). (s. 71.05(1)(f)3, Wis. Stats.)

6. Any amount necessary to prevent the double inclusion or omission of any item of income, deduction or basis in a tax-option corporation shareholder's taxable income. (ss. 71.05(1)(f)3 and 71.05(5), Wis. Stats.)

7. An amount which represents the difference in the federal and Wisconsin bases of property acquired by inheritance in the year of sale, exchange, abandonment or other disposition. (ss. 71.05(1)(g) and 71.05(5), Wis. Stats.)

8. The cost of any waste treatment plant or pollution abatement equipment acquired in 1969 or thereafter, subject to the conditions set forth in s. 71.05(1)(h) or (i), Wis. Stats. In the case of an individual who elects to claim a subtraction modification for the cost of such equipment, add modifications must be made in subsequent years to reverse federal depreciation or amortization or to correct gain or loss on disposition.

9. For the year of disposition of a partnership interest, an amount which reflects an increase or decrease in the basis of a partnership interest occurring in taxable years prior to 1975 as a result of losses or gains relating to business or property which had a situs outside Wisconsin. (s. 71.05(4)(b), Wis. Stats.)

#### D. Differences Between Wisconsin and Federal Law for 1984

For the 1984 taxable year, a Wisconsin net operating loss must be computed under the provisions of the Internal Revenue Code in effect on December 31, 1983 with the exceptions provided under section 71.02(2)(b)10, Wis. Stats. These exceptions are as follows:

1. Wisconsin allows an itemized deduction for political contributions as it was allowed under section 218 of the Internal Revenue Code prior to its repeal in 1978.

2. Wisconsin allows a foreign earned income exclusion of \$15,000 (\$20,000 for employees of U.S. charitable organizations) to residents who are working abroad. Wisconsin follows the provisions of section 911(c) of the Internal Revenue Code as it existed on December 31, 1977 in allowing this exclusion. The federal foreign earned income exclusion and a foreign housing cost exclusion or deduction allowed under the Internal Revenue Code in effect on December 31, 1983 is not recognized for Wisconsin tax purposes.

3. The federal special tax treatment of "incentive stock option" plans under section 422A of the Internal Revenue Code is not recognized for Wisconsin tax purposes.

Amendments to the Internal Revenue Code enacted after December 31, 1983 do not apply for Wisconsin tax purposes. Therefore, changes made by the federal Tax Reform Act of 1984 may not be used for Wisconsin purposes for 1984. A comprehensive list of the provisions of federal law which may not be used for Wisconsin purposes for 1984 can be found in the instructions for Wisconsin



## EXCERPTS FROM 1984 WISCONSIN FORM 1

Attach wage statements to

Attach check or money order here

**Computation of Wisconsin Total Income**

Single Persons-Complete only Column B.

Married Persons-For lines 5-25 enter in Column A amounts as they appear on Form 1040. Then enter in Column B and C amounts which would have been reported on separate Federal returns of husband and wife. Column A will not always equal Column B plus Column C.

	Column A Joint Total	Column B Single Person or Husband	Column C Wife
<b>Federal Income</b>			
5 Wages, salaries, tips, etc. (from Federal Form 1040, Line 7).....	5 9,505 00		9,505 00
6 Interest income (from Federal Form 1040, Line 8).....	6 500 00	250 00	250 00
7 Dividends (from Federal Form 1040, Line 9c; see instructions, page 3).....	7 250 00	125 00	125 00
8 Refunds of state and local income taxes (from Federal Form 1040, Line 10).....	8 400 00	Not taxable for Wisconsin	
9 Business income or loss (from Federal Form 1040, Line 12).....	9		
10 Capital gains or losses (from Federal Form 1040, Lines 13 and 14).....	10 440 00	220 00	220 00
11 Rents, royalties, etc. (from Federal Form 1040, Line 18).....	11		
12 Farm income or loss (from Federal Form 1040, Line 19).....	12 (16,505 00)	(16,505 00)	
13 Unemployment compensation (from Federal Form 1040, Line 20b; see instr., page 3).....	13		
14 Social Security benefits (from Federal Form 1040, Line 21b).....	14	Not taxable for Wisconsin	
15 Other income (from Federal Form 1040, Lines 11, 15, 16, 17b, and 22).....	15		
16 Total (Column A should agree with Federal Form 1040, Line 23).....	16 (5,410 00)	(15,910 00)	10,100 00
<b>Federal Adjustments</b>			
17 Moving expense (from Federal Form 1040, Line 24).....	17		
18 Employee business expenses (from Federal Form 1040, Line 25).....	18		
19 Payments to an IRA (from Federal Form 1040, Line 26a).....	19 1,000 00		1,000 00
20 Payments to a Keogh Plan (from Federal Form 1040, Line 27).....	20		
21 Interest penalty (from Federal Form 1040, Line 28).....	21		
22 Alimony paid (from Federal Form 1040, Line 29).....	22		
23 Married couple deduction (from Federal Form 1040, Line 30).....	23	Not deductible for Wisconsin	
24 Total adjustments (add Lines 17 through 23).....	24 1,000 00		1,000 00
25 Federal-Adjusted Gross Income (subtract Line 24 from Line 16) (Column A should agree with Federal Form 1040, Line 32).....	25 (6,410 00)	(15,910 00)	9,100 00
<b>Additions to Federal Income</b>			
26 State and municipal bond interest.....	26	250 00	250 00
27 Reinvested public utility stock dividends (from Federal Schedule B, Part II, Line 8).....	27	50 00	50 00
28 Other additions (Moving expenses to move from Wisconsin, etc.) see instructions, page 5.....	28		
29 Total additions (add Lines 26 through 28).....	29	300 00	300 00
30 Subtotal (add Lines 25 and 29).....	30 (15,610 00)		9,400 00
<b>Subtractions from Federal Income</b>			
31 United States Government interest and dividends.....	31	100 00	100 00
32 Disability income exclusion (attach Schedule 2440W).....	32		
33 Retirement benefits (see instructions, page 6).....	33		
34 Other (First \$1,000 of military pay, etc.) List:.....	34		
35 Total subtractions (add Lines 31 through 34).....	35	100 00	100 00
36a Wisconsin total income (subtract Line 35 from Line 30).....	36a (15,710 00)		9,300 00

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	Single Person or Husband	Wife
36b Wisconsin total income from line 36a.....	36b (15,710 00)	9,300 00
<b>Deductions</b> If you itemize deductions, complete Lines 37 through 41. If you claim the standard deduction, go on to Line 42.		
37 Total itemized deductions from Federal Schedule A, Line 24.....	37 4,500 00	
38 Political contributions deduction (see instructions, page 7).....	38	
39 Subtotal (add Lines 37 and 38).....	39 4,500 00	
40 Taxes from Federal Schedule A, Line 10.....	40 1,500 00	
41 Total Wisconsin itemized deductions (subtract Line 40 from Line 39).....	41 3,000 00	
42 Enter larger of itemized deductions (Line 41) or standard deduction (from tables, page 12 or 19) Nonresidents and part-year residents must enter prorated deductions on Line 42. See instructions, page 15.....	42	4,800 00
42a If you have unearned income and can be claimed as a dependent on anyone else's return, see instr., p. 8 and check here. <input type="checkbox"/>		
43 Wisconsin Net Taxable Income (subtract Line 42 from Line 36b).....	43 (15,710 00)	4,500 00

Attach wage statements here

The husband's 1984 Wisconsin net operating loss is computed by adjusting his federal adjusted gross income (loss) of \$(15,910) shown on line 25, Column B, by (1) the federal adjustments necessary to compute a federal net operating loss and (2) the Wisconsin modifications.

1984 Federal adjusted gross income	\$(15,910)	
Federal net operating loss adjustments:		
Add: Capital gain deduction	330	
Net operating loss before Wisconsin modifications	\$(15,580)	
Wisconsin modifications:		
Add: Municipal bond interest	250	
Add: Reinvested public utility stock dividends	50	
Subtract: U.S. Government bond interest	(100)	
1984 Wisconsin net operating loss	<u>\$(15,380)</u>	

#### C. Reconciliation of Federal and Wisconsin Net Operating Loss

The 1984 federal joint net operating loss can be reconciled to the husband's 1984 Wisconsin net operating loss as follows:

Federal joint net operating loss	\$ (7,575)	
Subtract: Wife's business income since she is separate taxpayer		
a. Wages	\$ 9,505	
b. Refund of state income taxes	300	(9,805)
Add: Wife's business deductions since she is separate taxpayer		
a. Casualty loss	\$ 500	
b. State income tax deduction	375	875
Add: Husband's Wisconsin non-business income in excess of husband's Wisconsin nonbusiness deductions of -0-		
a. Interest income	\$ 250	
b. Dividend income	125	
c. Capital gain income @ 100%	550	925
Net operating loss before Wisconsin modifications	\$(15,580)	
Wisconsin modifications		
Add: Municipal interest	\$ 250	
Add: Public utility stock dividends	50	
Subtract: U.S. Government bond interest	(100)	200
1984 Wisconsin net operating loss	<u>\$(15,380)</u>	

**Deduction of Wisconsin Net Operating Loss Carryforward:** A Wisconsin net operating loss not offset by income of the year of the loss may be carried forward and offset against Wisconsin taxable income of the five years subsequent to the year of the loss. The carryback of losses to reduce income of prior years is not permitted (s. 71.05 (1)(d), Wis. Stats.).

An addition modification is required on the Wisconsin tax return for any amount deducted as a federal net operating loss carryover in the computation of federal adjusted gross income. A subtraction modification is allowed for the Wisconsin net operating loss carryforward (s. 71.05 (1)(d),

Wis. Stats.). In 1984, these addition and subtraction modifications are reported on Wisconsin Form 1, line 28 and line 34, respectively. A schedule should be attached to the Wisconsin tax return showing how the Wisconsin net operating loss carryforward claimed as a subtraction modification is computed.

**Computation of Wisconsin Net Operating Loss Carryforward (NOLC):** In computing a Wisconsin net operating loss carryforward to subsequent years, the following items should be considered.

A. Wisconsin taxable income in the first year subsequent to the loss year is computed without regard to the subtraction modification for the Wisconsin net operating loss carryforward. Therefore, the itemized deductions, standard deduction or low income allowance are/is allowed in computing taxable income against which the net operating loss carryforward is applied.

B. A subtraction modification may be claimed for the Wisconsin net operating loss carryforward in any amount not in excess of Wisconsin taxable income computed without regard to the net operating loss carryforward.

C. The standard deduction or low income allowance should be recomputed based on Wisconsin total income after the deduction of the Wisconsin net operating loss carryforward.

D. The remaining Wisconsin net operating loss may be carried forward to the second year succeeding the loss year.

E. Wisconsin net operating losses should be carried forward in chronological order.

**Example 1:** A single taxpayer's 1984 federal adjusted gross income is computed as follows:

Business income	\$ 8,000
Interest income	2,000
Federal NOLC	<u>(3,000)</u>
Federal adjusted gross income	\$ 7,000

The Wisconsin net operating loss carryforward to 1984 is \$(10,000) and the Wisconsin itemized deductions are \$4,000. A subtraction modification for the Wisconsin net operating loss carryforward to 1984 is allowed in any amount not in excess of \$6,000 computed as follows:

Federal adjusted gross income	\$ 7,000
Add: Federal NOLC	<u>3,000</u>
Subtotal	\$ 10,000
Itemized deductions	<u>(4,000)</u>
Wisconsin taxable income before NOLC	\$ 6,000
Allowable Wisconsin NOLC	<u>\$ 6,000</u>

**Example 2:** A taxpayer is married, he and his spouse are under age 65 and they have one dependent. Adjusted gross incomes as computed on their 1984 Wisconsin Form 1 follow:

	Joint	Husband	Wife
Wages	\$ 10,000	\$ -0-	\$10,000
Interest income	1,900	1,600	300
Business loss	(300)	(300)	-0-
Federal NOLC	<u>(9,000)</u>	<u>(9,000)</u>	<u>-0-</u>
Federal adjusted gross income	\$ 2,600	\$ (7,700)	\$10,300

The husband's Wisconsin NOLC to 1984 is \$(10,000). The taxpayers claim the standard deduction and allocate it to the wife. The subtraction modification for the Wisconsin NOLC and the net taxable incomes are computed as follows:

	<u>Husband</u>	<u>Wife</u>
Wisconsin NOLC:		
Federal adjusted gross income	\$(7,700)	\$ 10,300
Add: Federal NOLC	<u>9,000</u>	<u>-0-</u>
Subtotal	\$ 1,300	\$ 10,300
Standard deduction	<u>      </u>	<u>(3,500)</u>
Wisconsin taxable income before NOLC	\$ 1,300	\$ 6,800
Allowable Wisconsin NOLC	<u>\$ 1,300</u>	
Wisconsin taxable income:		
Federal adjusted gross income	\$(7,700)	\$ 10,300
Add: Federal NOLC	<u>9,000</u>	<u>-0-</u>
Subtract: Wisconsin NOLC	<u>(1,300)</u>	<u>-0-</u>
Wisconsin total income	\$ -0-	\$ 10,300
Standard deduction	<u>      </u>	<u>(3,600)</u>
Wisconsin taxable income	<u>\$ -0-</u>	<u>\$ 6,700</u>

The Wisconsin net operating loss carryforward to 1985 is \$(8,700).

**Net Operating Losses and Household Income For Homestead/Farmland Preservation Credit:** "Household income" for purposes of the Homestead Credit means all "income" received by a claimant and his or her spouse in a calendar year while members of the household (ss. 71.09(7)(a)2 and 3, Wis. Stats.). "Household income" for purposes of the Farmland Preservation Credit means all "income" of the claimant, the claimant's spouse, and the minor dependents attributable to the income year while members of the household (ss. 71.09(11)(a)4 and 5, Wis. Stats.). "Income" means adjusted gross income plus adjustments defined in sections 71.09(7)(a)1 and 71.09(11)(a)6, Wis. Stats. Therefore, married persons must combine their incomes or losses in computing the household income and allowable credits.

In a year in which one spouse incurs a net operating loss, the Wisconsin total loss may be used to offset the Wisconsin total income of the other spouse in computing household income. In a year subsequent to the year of loss, a net operating loss carryforward may not be used to reduce the income of the other spouse in computing household income. The spouse that incurred the net operating loss may claim a subtraction modification for the carryforward in an amount not exceeding his or her Wisconsin net taxable income as computed before any net operating loss carryforward deduction. The Wisconsin total income computed after claiming the subtraction modification is then carried to Homestead Credit Schedule H or Farmland Preservation Credit Schedule FC for computation of household income.

**Example:** A 1984 Homestead Credit claimant is married, he and his spouse are under age 65 and they have one dependent. The claimant has business income of \$3,000 and a Wisconsin and federal net operating loss carryforward to 1984 of \$(9,000). The claimant's spouse has interest income of \$8,000. Their federal adjusted gross income on their joint federal return is \$2,000.

Assuming that these taxpayers have Wisconsin total itemized deductions of \$9,000 in 1984 and they allocate the deductions as shown, the Wisconsin total incomes of each spouse to be carried forward to Homestead Credit Schedule H are computed as follows:

	<u>Husband</u>	<u>Wife</u>
Wisconsin net operating loss carryforward:		
Federal adjusted gross income	\$(6,000)	\$ 8,000
Add: Federal NOLC	<u>9,000</u>	
Subtotal	\$ 3,000	\$ 8,000
Itemized deductions	<u>(1,000)</u>	<u>(8,000)</u>
Wisconsin net income before NOLC	\$ 2,000	\$ -0-
Allowable Wisconsin NOLC	<u>\$ 2,000</u>	<u>\$ -0-</u>
Wisconsin total income:		
Federal adjusted gross income	\$(6,000)	\$ 8,000
Add: Federal NOLC	<u>9,000</u>	
Subtract: Wisconsin NOLC	<u>(2,000)</u>	
Wisconsin total income (to Schedule H)	<u>\$ 1,000</u>	<u>\$ 8,000</u>

## CORPORATION FRANCHISE/INCOME TAXES

### 1. ACRS Depreciation Not Allowable on Non-Wisconsin Assets

**Facts:** The federal accelerated cost recovery system (ACRS) is not allowed for Wisconsin franchise/income tax purposes for property located outside Wisconsin and first placed in service on or after January 1, 1983 pursuant to 1983 Wisconsin Act 27. Instead, depreciation for out-of-state property first placed in service by a corporation on or after January 1, 1983 must be computed under the methods permitted by the Internal Revenue Code (IRC) as of December 31, 1980 or, in the alternative, the IRC applicable to the calendar year 1972.

Except for utility companies (which are required to use the same methods available for out-of-state property), property located in Wisconsin may be depreciated under ACRS, regardless of when acquired.

Special provisions apply to (1) corporations which have been operating outside Wisconsin and which first commence business activities in Wisconsin on or after January 1, 1983, (2) property acquired in reorganizations, (3) computing the Wisconsin basis of property transferred into and out of Wisconsin, and (4) establishing whether or not mobile equipment is located in Wisconsin. The above depreciation treatment applies to all corporations, including insurance companies, tax-option (S) corporations, regulated investment companies and real estate investment trusts.

**Question 1:** How is depreciation to be computed on property placed in service on or after January 1, 1983 and located outside of Wisconsin?

**Answer 1:** Depreciation is to be computed under the IRC applicable to the 1972 calendar year or as of December 31, 1980. These codes allow any consistent method as long as the total deductions during the first two-thirds of the useful life are not more than the total allowable under the double declining balance method. These methods include the declining balance method, declining balance with change to straight line, sum of the years-digits method, sum of the years-digits remaining life method, straight line method, etc. The life of the property must be determined under either Revenue Procedure 72-10 or Revenue Procedure 77-10.

**Question 2:** How must records be kept to comply with the new Wisconsin law?

**Answer 2:** A separate set of depreciation records will have to be kept for Wisconsin tax purposes (unless the taxpayer desires to claim book depreciation and book depreciation is within the guidelines noted in answer 1 above).

**Question 3:** Must ACRS be used on Wisconsin property placed in service on or after January 1, 1983?

**Answer 3:** No. If the taxpayer does not desire to use ACRS on property located in Wisconsin it may use any method that comes within the guidelines noted in answer 1 above.

**Question 4:** How is depreciation to be computed when property is transferred into or out of Wisconsin?

**Answer 4:** For any out-of-state asset (first placed in service on or after January 1, 1983) transferred into Wisconsin, ACRS depreciation is allowable beginning with the year the asset is placed in service in Wisconsin. However, the taxpayer may continue to depreciate the asset using the method and life elected for Wisconsin purposes when the asset was first placed in service.

If the taxpayer elects to switch to ACRS depreciation, the remaining Wisconsin basis of the asset would be depreciated over the ACRS life as if the asset was newly acquired.

On assets transferred out of Wisconsin, which were placed in service on or after January 1, 1983 and on which ACRS depreciation is being claimed, ACRS is no longer allowable. In this case the depreciation must be computed using the ADR life over the remaining years. On an asset transferred out of Wisconsin ACRS depreciation may be used until the date of transfer.

**Example:** Property with a cost of \$10,000 was placed in service in Wisconsin in February, 1983. It qualifies as five (5) year ACRS property and ten (10) year ADR property. In 1985, it is transferred out of Wisconsin. Taxpayer elects the double declining balance method with change to straight line. Taxpayer files on a calendar year basis. Depreciation would be computed as follows:

	Method	Basis Beginning Year	Rate	Depreciation
1983	ACRS	\$10,000	15%	\$1,500
1984	ACRS	8,500	22	2,200
1985	DDB	6,300	25	1,575
1986	DDB	4,725	25	1,181
1987	DDB	3,544	25	886
1988	DDB	2,658	25	665
1989	DDB	1,993	25	498

1990	SL	1,495	33	498
1991	SL	997	33	498
1992	SL	499	33	499

The double declining balance rate is determined from the eight years of life remaining at the time of the transfer ( $10 - 2 = 8$ ;  $1/8 \times 2 = 25\%$ ).

**Question 5:** How is gain or loss to be computed on dispositions of property?

**Answer 5:** If property is sold before it is entirely depreciated, depreciation is computed in the year of sale based on the method in use at the time of sale. Gain or loss is computed using this adjusted basis.

**Examples:**

A. Same facts as in 4 above except that the property was sold on October 16, 1987 for \$5,000. Depreciation in 1987 would be \$738 ( $10/12 \times \$886$ ). The gain on the sale would be \$2,194 ( $\$5,000 - \$2,806$ ).

B. Same facts as in 4 above except that the property was sold on October 15, 1987 for \$5,000. Depreciation in 1987 would be \$665 ( $9/12 \times \$886$ ). The gain on the sale would be \$2,121 ( $\$5,000 - \$2,879$ ). Note: Depreciation is not allowed for October since the property was owned for less than half a month.

C. Same facts as in 4 above except that the property was sold on October 16, 1984 for \$5,000. Depreciation for 1984 is zero (under ACRS no depreciation is allowed in the year of disposition for 5 year property). The loss on the sale is \$3,500.

**Question 6:** How is depreciation to be computed on mobile equipment?

**Answer 6:** ACRS depreciation is allowable for mobile equipment placed in service on or after January 1, 1983 and deemed to be located in Wisconsin. If mobile equipment is not deemed to be located in Wisconsin, the allowable depreciation is computed as noted in answer 1 above.

Section 71.04 (15)(f) of the Wisconsin Statutes provides that mobile equipment is deemed to be located in the state it is licensed or registered. If mobile equipment is not required to be licensed or registered, then it is deemed to be in Wisconsin provided it is in Wisconsin at least 50% of the days from the date placed in service to the end of the year.

**Example:** A contractor located in Beloit owns and garages a truck in Beloit. The truck, which was placed in service on July 1, 1983, is registered in Wisconsin but is used 75% of the time in Illinois. Since the truck is registered in Wisconsin it is considered located in Wisconsin and ACRS depreciation is therefore allowable.

**Question 7:** If an existing corporation first commences business in Wisconsin after January 1, 1983, what is the basis of its out-of-state assets and how is depreciation computed?

**Answer 7:** Section 71.04 (15)(fn) of the Wisconsin Statutes provides that an existing corporation operating in Wisconsin for the first time on or after January 1, 1983 must compute the adjusted basis of its out-of-state property first placed in service on or after January 1, 1983 under the IRC as of December 31, 1980.



**Example:** Corporation X has two properties, one acquired in 1982 and one in 1983. Both properties cost \$10,000 and are five year ACRS property. Corporation X starts doing business in Wisconsin in 1984, and files its first return for that year. The basis of the property acquired in 1982 is \$6,300 based on ACRS deductions for 1982 and 1983 (15% and 22% respectively).

The basis of the 1983 property must be computed based on an allowable method. Double declining balance and a 10 year life would give the 1983 property a \$9,000 basis ( $1/2 \text{ year} \times 10,000 \times 20\%$ ).

**Question 8:** If out-of-state property is acquired in a reorganization, what is the basis of these assets and how is depreciation computed?

**Answer 8:** Section 71.04 (15)(fo) of the Wisconsin Statutes provides that the basis of out-of-state property first placed in service on or after January 1, 1983 and acquired in a reorganization on or after January 1, 1983 must be computed under the IRC as of December 31, 1980. The same principal applies here as in question 7 above.

## 2. Wisconsin Net Operating Loss and Wisconsin Net Operating Loss Carryforward

(This Tax Release supersedes the Tax Release with the same title contained in *Wisconsin Tax Bulletin* #21, January 1981.)

**Background:** Section 71.06 of the Wisconsin Statutes provides in part that "a corporation may offset against its Wisconsin net business income any Wisconsin net business loss sustained in any of the next 5 preceding income years to the extent not offset by other items of Wisconsin income in the loss year and by Wisconsin net business income of any year between the loss year and the income year for which an offset is claimed. For purposes of this section Wisconsin net business income or loss shall consist of all the income attributable to the operation of a trade or business in this state, less the business expenses allowed as deductions under s. 71.04."

**Facts and Questions:** How is s. 71.06 interpreted as it relates to the situations described below:

### A. What constitutes an income year?

An income year is any period for which a corporation is required to file a return. This normally is for a 12 month period. However, if a corporation changes its year end from one fiscal year to another fiscal year or to a calendar year or from a calendar year to a fiscal year, a short period return is required. In such a case, this short period return constitutes one income year. (In no case shall a return be made for a period of more than 12 months.)

### B. What happens to the net business loss of a corporation which is a party to a reorganization?

If the laws of the state pursuant to which the reorganization was accomplished provide for continued existence of the dissolved company in the survivor, the Wisconsin net business loss may be carried forward; if they do not provide for continued existence, the Wisconsin net business loss may not be carried forward. The laws of Wisconsin do

not provide for continued existence, so that in reorganizations accomplished pursuant to Wisconsin statutes, the Wisconsin net business loss of the dissolved corporation *cannot* be carried forward.

### C. For what items of income must the loss be adjusted or offset against?

In light of the recent Wisconsin Supreme Court decision in *Midland Financial Corporation vs. Wisconsin Department of Revenue* (116 Wis. 40 (1983)) and the Winnebago County Circuit Court decision in *Overly, Inc. vs. Wisconsin Department of Revenue* (83 CV 293, March 26, 1984), the computation of a corporation's Wisconsin net operating loss carryforward has been altered for all corporations *except* insurance companies, real estate investment trusts and regulated investment companies.

Prior to the above court decisions the Department's interpretation of s. 71.06 was that the Wisconsin net business loss carryforward must be adjusted for items such as exempt interest, deductible dividends, nontaxable life insurance proceeds and s. 71.337 gains for all corporations *except* insurance companies, real estate investment trusts and regulated investment companies.

As a result of the *Midland* and *Overly* decisions, the Department's policy regarding the Wisconsin net business loss carryforward is as follows:

(1) For all corporation *franchise* taxpayers (except insurance companies, real estate investment trusts and regulated investment companies) the offset is the net loss without any adjustment for the above items.

(2) For all corporation *income* taxpayers (except insurance companies, real estate investment trusts and regulated investment companies) the net loss must be adjusted by exempt interest on obligations of the U.S. government in all affected years (*Red Star Yeast and Products Company, a Wisconsin Corporation, vs. Wisconsin Department of Taxation* (2 WBTA 17)).

(3) For insurance corporation taxpayers, both franchise and income, the net loss computed under s. 71.01(4) must continue to be adjusted by deductible dividends received in all affected years based on the specific statutory language found in s. 71.06(3) which refers to the dividends received deduction for insurance companies under s. 71.01(4)(a)7. No adjustment is required for interest received on obligations of the U.S. government because such interest is includable in both federal and Wisconsin gross income.

(4) For real estate investment trusts and regulated investment companies the provisions of the Internal Revenue Code in effect for the year in question govern the computation of the net business loss offset (s.71.02(1)(a)).

The above policy applies to all years open to assessment or refund.

The following examples illustrate the change in the computation of Wisconsin net business loss carryforward in light of the *Midland* and *Overly* decisions:

Example 1:

(a) Facts: A domestic manufacturing corporation which operates entirely within Wisconsin reported the following on its 1982 and 1983 Wisconsin franchise tax returns:

	1982	1983
Wisconsin net income (loss) before offset	\$(30,000)	\$ 50,000
Deductible dividends or exempt income:		
Deductible dividends	1,000	2,000
Gain on life insurance death benefit	15,000	

(b) Computation of Loss Offset Available:(1) Old Method:

Wisconsin net income (loss) before offset	\$(30,000)	\$ 50,000
Adjustments:		
Deductible dividends	1,000	2,000
Gain on life insurance death benefit	15,000	
Adjusted Wisconsin net income (loss)	<u>\$(14,000)</u>	\$ 52,000
Net income before offset per return		<u>\$ 50,000</u>
Income to reduce loss offset		<u>\$ 2,000</u>
1982 adjusted loss		<u>(14,000)</u>
Wisconsin net business loss offset to claim on 1983 return		<u><u>\$(12,000)</u></u>

(2) New Method:

Wisconsin net income (loss) before offset	\$(30,000)	\$ 50,000
Adjustments:		
None	-0-	-0-
Adjusted Wisconsin net income (loss)	<u>\$(30,000)</u>	\$ 50,000
Net income before offset per return		<u>50,000</u>
Income to reduce loss offset		<u>\$ -0-</u>
1982 adjusted loss		<u>(30,000)</u>
Wisconsin net business loss offset to claim on 1983 return		<u><u>\$(30,000)</u></u>

Example 2:

(a) Facts: A domestic manufacturing corporation files a 1982 Wisconsin franchise tax return and files Wisconsin income tax return for 1983 as a result of a liquidation during the year. This corporation reported the following:

	1982	1983
Wisconsin net income (loss) before offset	\$(30,000)	\$ 40,000
Deductible dividends or exempt income:		
Deductible dividends	3,000	5,000
Sec. 337 gains excluded		20,000
U.S. interest income		1,000

(b) Computation of Loss Offset Available:(1) Old Method:

Wisconsin net income (loss) before offset	\$(30,000)	\$ 40,000
Adjustments:		
Deductible dividends	3,000	5,000
Sec. 337 gains excluded		20,000
U.S. interest income		<u>1,000</u>
Adjusted Wisconsin net income (loss)	<u>\$(27,000)</u>	\$ 66,000
Net income before offset per return		<u>\$ 40,000</u>
Income to reduce loss offset		<u>\$ 26,000</u>
1982 adjusted loss		<u>(27,000)</u>
Wisconsin net business loss offset to claim on 1983 return		<u><u>\$ (1,000)</u></u>

(2) New Method:

Wisconsin net income (loss) before offset	\$(30,000)	\$ 40,000
Adjustments:		
U.S. interest income		<u>1,000</u>
Adjusted Wisconsin net income (loss)	<u>\$(30,000)</u>	\$ 41,000
Net income before offset per return		<u>40,000</u>
Income to reduce loss offset		<u>\$ 1,000</u>
1982 adjusted loss		<u>(30,000)</u>
Wisconsin net business loss offset to claim on 1983 return		<u><u>\$(29,000)</u></u>

Example 3:

(a) Facts: A unitary manufacturing corporation with business in more than one state filed its Wisconsin franchise tax returns for 1982 and 1983 using the apportionment method. The following information was included in these returns:

	1982	1983
Total company net income (loss)	\$(25,000)	\$ 32,000
Total company nonapportionable income (loss)	(1,000)	2,000
Apportionable income (loss)	\$(24,000)	\$ 30,000
Percent to Wisconsin	66.67%	60%
Amount to Wisconsin	\$(16,000)	\$ 18,000
Wisconsin nonapportionable income (loss)	-0-	-0-
Wisconsin net income before offsets per return	<u>\$(16,000)</u>	<u>\$ 18,000</u>

Items included or deducted in above:

Loss on sale of out-of-state business assets	\$ (6,000)(1)	
Loss on sale of out-of-state nonbusiness assets	(4,000)(2)	
Net nonbusiness rental income outside Wisconsin	3,000 (2)	\$ 2,000(2)
Deductible dividends	9,000	10,000

(1) Apportionable loss

(2) Income (loss) included in nonapportionable

(b) Computation of Loss Offset Available

	1982	1983
(1) Old Method:		
Total company net income (loss)	\$(25,000)	\$ 32,000
Adjustment:		
Deductible dividends	9,000	10,000
Adjusted total net income (loss)	\$(16,000)	\$ 42,000
Total company nonapportionable income (loss)	(1,000)	2,000
Apportionable income (loss)	\$(15,000)	\$ 40,000
Percent to Wisconsin	66.67%	60%
Amount to Wisconsin	\$(10,000)	\$ 24,000
Wisconsin nonapportionable income	-0-	-0-
Adjusted Wisconsin net income (loss)	<u>\$(10,000)</u>	<u>\$ 24,000</u>
Wisconsin net income before offset per return		18,000
Income to reduce loss offset		\$ 6,000
1982 adjusted loss		(10,000)
Wisconsin net business loss offset to claim on 1983 return		<u>\$ (4,000)</u>

(2) New Method:

Total company net income (loss)	\$(25,000)	\$ 32,000
Adjustment:		
None	-0-	-0-
Adjusted total net income (loss)	\$(25,000)	\$ 32,000
Total company nonapportionable income (loss)	(1,000)	2,000
Apportionable income (loss)	\$(24,000)	\$ 30,000
Percent to Wisconsin	66.67%	60%
Amount to Wisconsin	\$(16,000)	\$ 18,000
Wisconsin nonapportionable income	-0-	-0-
Adjusted Wisconsin net income (loss)	<u>\$(16,000)</u>	<u>\$ 18,000</u>
Wisconsin net income before offset per return		18,000
Income to reduce loss offset		\$ -0-
1982 adjusted loss		(16,000)
Wisconsin net business loss offset to claim on 1983 return		<u>\$(16,000)</u>

**HOMESTEAD CREDIT****1. The Definition of a "Farm" for Homestead Credit Purposes**

Law: For purposes of computing allowable taxes in the computation of homestead credit, Wisconsin Statutes s. 71.09(7)(a)8 provides that "If the homestead is part of a farm, 'property taxes accrued' are the property taxes accrued on up to 120 acres of land contiguous to the claimant's principal residence and include the property taxes accrued on all improvements to real property located on such land, except as the limitations of par. (h) apply." If a homestead is not part of a farm nor a multipurpose nor multidwelling building, property taxes are allowed on the dwelling and so much of the land surrounding it, not exceeding one acre, as is reasonably necessary for the use of the dwelling as a home.

Question: What is a "farm" as used in s. 71.09(7)(a)8?

Answer: If the current or most recent use of the land, while owned by the present owner, was for agricultural purposes, then the property would generally be considered a farm and the claim would be based on the homestead and other improvements on up to 120 acres. ("Agricultural purposes" in this Tax Release means the business of producing food products or other useful crops by tilling and cultivating the soil or by raising cattle, sheep, poultry, domesticated rabbits or other animals which produce a food product or which are themselves a food product and includes raising pheasants, foxes, fitch, nutria, marten, fisher, mink, chinchilla, rabbit, caracul and bees; producing honey products by a beekeeper of 50 or more hives; commercial raising of fish for food; commercial breeding and raising of horses for sale; and raising ginseng, mushrooms and sod. The term "agricultural purposes" does not include home gardening and other similar noncommercial activities; breeding or raising dogs, cats, other pets or animals intended for use in laboratories; raising earthworms; operating sporting or recreational facilities such as riding stables or shooting preserves; operating stockyards, slaughterhouses or feed lots; lumbering and logging, and pulpwood and sawmill operations; milling and grinding grain; and preparing sausage, canned goods, jellies,

juices or syrup.) However, if the current or most recent use of the land was non-agricultural, such as use for recreational purposes, then the property would not be considered a farm and a homestead located on such land would be limited to one acre.

Examples:

A. Claimant's homestead is located on a 120 acre tract of land on which he is currently growing crops. He is entitled to base his claim on the 120 acres including his residence and other improvements on the property.

B. Claimant's homestead is located on a 200 acre tract of land which he rents out to his neighbor. His neighbor grows crops on the land. The claimant is entitled to base his claim on the 120 acres which includes his residence and other improvements.

C. Claimant's homestead is located on a 40 acre tract of land which is currently sitting idle. He previously had

grown crops on this land but since his retirement three years ago, the land has not been used. Claimant is entitled to base his claim on the 40 acres including his residence and other improvements.

D. Claimant's homestead is located on a 40 acre tract of land on which, up until his retirement five years ago, he had grown crops. During the last five years he has leased this land to an organization which has utilized it for recreational purposes. The claimant is entitled to base his claim on his residence and up to only one acre of land.

E. Claimant bought a 10 acre tract of land from a farmer and built his residence on it two years ago. This land has not been used for commercial agricultural purposes since he purchased it. Claimant is entitled to base his claim on his residence and up to only one acre of land.