WISCONSIN TAX BULLETIN

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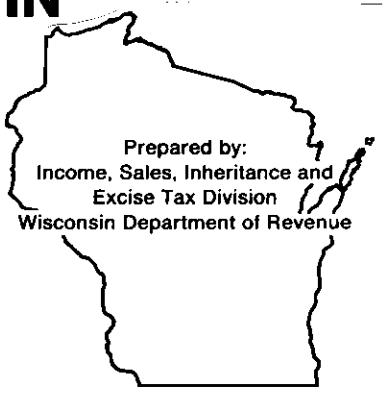

NEW TAX LAWS

The 1985-87 budget bill was still pending before the Wisconsin Legislature at the time this issue went to press. As soon as that bill becomes law, a special issue of the Wisconsin Tax Bulletin will be published to provide information about the tax law changes it contains.

OCCASIONAL SALE STANDARDS INCREASED

Wisconsin Administrative Code section Tax 11.10, titled "Occasional Sales" has been revised. The rule amendments increase the occasional sale standard for nonprofit organizations from $1,000 to $2,500 of taxable type gross receipts during a calendar year, effective January 1, 1985. The $1,000 standard had been in effect for approximately 15 years.

The occasional sale standard for persons other than nonprofit organizations was increased from $500 of taxable type gross receipts per calendar year to $1,000 per year, also effective on January 1, 1985. This is found in sub. (5) of the rule. This $1,000 standard now applies to every type of taxable receipt from sales of tangible personal property or taxable services. Previously it only applied to the items specified in the rule. (Note: Sellers who qualify for an exemption on their sales are still required to pay tax on their purchases as described in sub. (5)(c).)

A copy of the revised rule, section Tax 11.10, can be found on page 26 of this issue.

IN THIS ISSUE

TAXABLE NONCASH FRINGE BENEFITS ARE SUBJECT TO WISCONSIN WITHHOLDING TAX BEGINNING JULY 1, 1985

For taxable year 1985, certain noncash fringe benefits which employes receive from their employers are subject to the Wisconsin income tax. Examples of taxable noncash fringe benefits include: use of employer provided automobiles for commuting, an employer provided vacation, free or discounted commercial airline flights and employer provided tickets to an entertainment event.

The determination of whether a fringe benefit is taxable for Wisconsin is based on federal income tax law. Noncash fringe benefits which are taxable for federal income tax purposes are also taxable for Wisconsin.

Beginning July 1, 1985, the taxable noncash fringe benefits an employer provides to an employe must be treated as additional wages received by the employe for withholding tax purposes. An additional amount of Wisconsin income tax must be withheld from the employe's regular wages, based on the amount of taxable noncash fringe benefits. (Note: Noncash fringe benefits received by employes from January 1, 1985 through June 30, 1985 may also be taxable income to the employe. However, Wisconsin income tax is required to be withheld only for taxable noncash fringe benefits "paid" after July 1, 1985. See "When A Fringe Benefit is Paid for Withholding Purposes", below.)

(Note: Federal law permits an employer to elect not to withhold federal income tax for taxable noncash fringe benefits which employes realize from the use of an employer provided vehicle. This election also applies for Wisconsin purposes.)

How the Amount of Withheld Wisconsin Income Tax Should be Determined

An employer may use either of the following two methods to determine the amount of Wisconsin income tax to be withheld from employes who receive taxable noncash fringe benefits:

Method 1 - Combine Taxable Noncash Fringe Benefits and Regular Wages

Under this method, the amount of taxable noncash fringe benefits received by an employe during a payroll period should be added to the employe's wages for that payroll period. The total amount of Wisconsin income tax to be withheld should then be determined as if the total of the taxable noncash fringe benefits and wages constituted a single wage payment for the payroll period.

Example: A single employe has semi-monthly wages of $1,600 and claims one withholding exemption. During the payroll period this employe also received a taxable noncash fringe benefit valued at $150.

$1750 - Total of wages and taxable noncash fringe benefits ($1,600 + $150 = $1750)

$131.90 - Wisconsin income tax to withhold (per semi-monthly table in Wisconsin Employer's Withholding Tax Guide dated June 30, 1981)

Method 2 - Treat Taxable Noncash Fringe Benefits as Supplemental Wage Payments

Under this method, a taxable noncash fringe benefit is treated as a supplemental wage payment. Withholding is determined by estimating the employe's annual gross salary (including taxable noncash fringe benefits) and then multiplying the amount of the taxable noncash fringe benefit by a flat percentage. Instructions for the use of this method and a listing of flat percentage rates which must be used can be found on page 9 of the Wisconsin Employer's Withholding Tax Guide (the current guide has a date of June 30, 1981 on the front cover).

The amount to be withheld for the taxable noncash fringe benefit must be added to the withholding determined for the employe's regular wages for the payroll period in which the taxable fringe benefit is paid. The resulting total is then to be withheld from the employes regular wages for that payroll period.

Example: A single employe receives taxable noncash fringe benefits of $150 during the current payroll period. The employe's estimated annual gross salary (including taxable noncash fringe benefits) is $29,000. Using the schedule of flat percentages found on page 9 of the Wisconsin Employer's Withholding Tax Guide, withholding of $14.25 ($150 × 9.5% = $14.25) would be determined. The $14.25 would be added to the withholding determined for the employe's regular wages. The resulting total would be withheld from the regular wages.

How the Value of Taxable Noncash Fringe Benefits is Determined

The federal rules for determining the value of taxable noncash fringe benefits also apply for Wisconsin. The Internal Revenue Service has issued temporary regulations prescribing methods to be used by employers to value various types of noncash fringe benefits. (See Treasury Decisions 8004 and 8009 issued by the Internal Revenue Service.)

When a Fringe Benefit is "Paid" for Withholding Purposes

The same rules that apply for federal income tax purposes also apply for Wisconsin. Generally, these rules provide that an employer may deem a noncash fringe benefit to be paid at any time on or after the date on which it is provided to the employe, as long as it is on or before the last day of the calendar quarter in which the benefit is provided. For example, a benefit provided on April 18, 1985 could be considered "paid" at any time from then to June 30, 1985.

When a taxable noncash fringe benefit is deemed paid on or after July 1, 1985 it is subject to the Wisconsin withholding tax. Wisconsin income tax is not required to be withheld for a taxable noncash fringe benefit paid prior to July 1, 1985.

When Amounts Withheld for Fringe Benefits are to be Deposited

Wisconsin income tax withheld from employes receiving taxable noncash fringe benefits should be included with an employer's regular withholding tax deposit report, Wisconsin Form WT-6. The amount withheld for fringe benefits should be deposited in the same manner as regular withholding. A separate deposit report is not required. For example, an employer with a semi-monthly reporting period would report all amounts of regular and fringe benefit withholding for the period of July 1, 1985 through July 15, 1985 as one amount on the Form WT-6 required to be filed by July 31, 1985.

Questions

If you have questions phone (608) 266-2776 in Madison or the nearest department office. If you write, address your letter to: Wisconsin Department of Revenue, Compliance Bureau, P.O. Box 8902, Madison, WI 53708.

FORM 101S - WISCONSIN SPOUSAL INHERITANCE TAX RETURN - REVISED

Wisconsin Form 101S has been redesigned to simplify inheritance tax reporting requirements. Form 101S may be used when the surviving spouse is the only person (with one exception) receiving property and date of death is on or after July 1, 1982. If property totalling $5,000 or less passes to the decedent's issue (including sons- and daughters-in-law), Form 101S may still be used.

The revised Form 101S serves two purposes: (1) It is a declaration by the surviving spouse that he or she is the only person receiving property with the exception stated above, and (2) it serves as a Certificate Determining No Inheritance Tax which is necessary in probate proceedings.

Since an inheritance tax is not owed by a surviving spouse, it is not necessary to list the decedent's property or itemize deductions.

The revised form is a two-ply form and is to be filed with the Department of Revenue in duplicate. After acceptance by the Inheritance and Excise Tax Bureau, the original will be date-stamped, signed and immediately returned to the preparer for purposes of filing with the Circuit Court. The duplicate will be processed to record the closing of the decedent's estate.

The revised Form 101S has been received by the department and will be mailed out by request. A copy of Form 101S can be found on page 29 of this issue.

INHERITANCE TAX BOARD OF REVIEW CREATED

On May 1, 1985, the Department of Revenue created an Inheritance Tax Board of Review. It offers an alterna-

tive to petitioning the Circuit Court when the Department's Inheritance and Excise Tax Bureau and the estate representatives cannot reach agreement. The three person board includes Kurt Kaspar, Director of ISI&E Technical Services; Clayton Seth, Appellate Bureau Director; and Neal Schmidt, member of the Department's Legal Staff.

Current Process

Under current inheritance tax law, the Department of Revenue determines the inheritance tax due. That process is initiated when the representative of the estate files an inheritance tax return. The return is audited by the department and the tax is determined - either as reported by the representative of the estate, or adjusted as a result of the department's audit. If the department agrees with the tax due as reported on the return, the estate is closed. If, when audited, the tax is adjusted by the department, the representative of the estate has only two choices — (1) agree with the department's adjustments and pay any additional tax or less tax and the matter is closed, or (2) disagree and file in Circuit Court for a redetermination of the inheritance tax due.

New Process

A. Inheritance Tax Return Correct as Filed

Inheritance tax returns are received by the department and audited. If the return is accurate and complete, the estate is closed and the Certificate Determining Inheritance Tax is prepared and issued to the representative of the estate. (Same as current process)

B. Department Disagrees with Inheritance Tax Due Per Return

If the department determines the inheritance tax due to be different from that reported by the estate, the department will send the representative a Notice of Inheritance Tax Adjustment which explains the basis for the adjustment. If the representative agrees with the auditor's determination, the estate is closed and the certificate is issued.

If the representative disagrees he or she will respond to the notice with an objection and supporting justification. The auditor will review that objection and either agree with the estate (and issue the closing certificate) or disagree. If the auditor still disagrees with the representative, he or she will issue (after supervisory review) a proposed determination of inheritance tax which includes instructions for filing an appeal with the department's new Inheritance Tax Board of Review.

Those estates choosing to appeal to the Inheritance Tax Board of Review will file their appeal with the board by submitting all necessary documentation and computation schedules in support of their appeal.

After conducting the necessary conferences with the estate's representative and audit staff and reviewing the oral and written evidence, the Board of Review may find in whole or in part in favor of either the department or the estate. The board's decisions will be binding upon the department. However, the estate may either agree with the board or disagree and petition the court. Additionally, the board is empowered to offer a compromise for settlement purposes only. If the estate accepts the board's settlement offer, they will so stipulate and the estate will be closed. If the settlement offer is rejected by the estate, the department will issue its final determination without regard to the settlement offer.

VOLUNTARY WITHHOLDING OF RETIREMENT PAY OF UNIFORMED SERVICE MEMBERS

The Wisconsin Department of Revenue has entered into a tentative agreement, effective July 1, 1985, with the U. S. Department of Defense to allow for the voluntary withholding of Wisconsin income taxes from the retirement pay (retainer pay) of various uniformed service personnel who are residents of Wisconsin. Personnel included are retired members of the Army, Navy, Air Force, Marine Corps, Coast Guard, commissioned corps of the Public Health Service, and the commissioned corps of the National Oceanic and Atmospheric Administration.

The agreement provides that a retiree may request voluntary withholding by contacting their respective service pay office noted below. This method of withholding may relieve approximately 12,000 uniformed service retirees in Wisconsin of the need to file a Wisconsin Declaration of Estimated Tax. Amounts withheld will be deposited with the State of Wisconsin. Statements of tax withheld will be furnished to retirees each year in order for them to file their income tax returns.

Retirees desiring to have an amount withheld from their retirement pay should provide the following information in writing to their respective pay office when requesting voluntary withholding.

A. Full name
B. Social security number
C. Monthly amount to be withheld - whole dollar amount, not less than $10.00
D. State designated to receive the amounts withheld - Wisconsin residents should indicate Wisconsin
E. Current residence address

The request must be signed by the retiree or his/her guardian or trustee.

It may take at least six weeks for the processing of a request made to a pay office noted below.

Army

Commanding Officer
U.S. Army Finance and Accounting Center
(Dept. 90)
Indianapolis, Indiana 46249
(800) 428-2290

Navy

Commanding Officer
Navy Finance Center (Code 301)
Anthony J. Celebrezze Federal Building
Cleveland, Ohio 44199
(800) 321-1080

Air Force

Commander
Air Force Accounting and Finance Center
ATTN: RP
Denver, Colorado 80279
(800) 525-0104

Marine Corps

Commanding Officer (CPR)
Marine Corps Finance Center
Kansas City, Missouri 64197
(816) 926-7130

Coast Guard

Commanding Officer (Retired)
U.S. Coast Guard Pay and Personnel Center
444 S.E. Quincy Street
Topeka, Kansas 66683
(913) 295-2657

Public Health Service (commissioned corps)

U.S. Public Health Service
Compensation Branch
5600 Fisher Lane (Room 4-50)
Rockville, Maryland 20857
(800) 638-8744

National Oceanic and Atmospheric Administration (commissioned corps)

Commanding Officer
Navy Finance Center (Code 301)
Anthony J. Celebrezze Federal Building
Cleveland, Ohio 44199
(800) 321-1080

All inquiries and requests regarding this agreement should be directed to the appropriate service office. The Wisconsin Department of Revenue cannot accept requests for participation by individual retirees.

CONVICTION FOR POSSESSION OF UNTAXED CIGARETTES

A West Allis man was convicted in Kenosha County Court on charges of possession of untaxed cigarettes. Robert J. Konopka was sentenced to a $75 fine and forfeiture of the auto used to transport the cigarettes.

The charges stemmed from an arrest by Wisconsin Department of Revenue agents on I-94 just north of the Illinois state line. The agents observed Konopka entering Wisconsin with cigarettes purchased in Illinois. The agents seized over 35,000 untaxed cigarettes at the time of the arrest.

Authorities also seized Konopka's 1979 Pinto station wagon. Under Wisconsin law, cars and other personal property used to transport smuggled cigarettes may be confiscated by law enforcement officers.

CONVICTIONS FOR CRIMINAL VIOLATIONS OF STATE INCOME TAX LAWS

James J. Martin, Route 1, Onalaska, President of James Martin Trucking, Inc., was sentenced in La Crosse County Circuit Court, Branch 1, by Circuit Judge Peter G. Pappas on one count of state income tax evasion and one count of theft. Judge Pappas fined Martin $6,000 on each count and ordered him to serve 18 months in prison on each count, to be served consecutively. Martin pled no contest to both charges on December 28, 1984.

Criminal charges were filed against Martin by the La Crosse County District Attorney's office after an investigation by the Intelligence Section of the Wisconsin Department of Revenue, the Wisconsin Department of Justice and the La Crosse County Sheriff's Department. Martin was charged with failing to report more than $75,000 in taxable income on his 1979 Wisconsin individual income tax return and evading more than $6,500 in state income taxes for that year.

Paul G. Beck and Judith I. Beck of West Allis, Wisconsin were each placed on three years probation in Dane County Circuit Court, Branch 8, by Reserve Circuit Judge William L. Jackman for criminal violations of Wisconsin state income tax laws. Under the conditions of probation, Mr. Beck must serve 90 days in jail, Mrs. Beck must pay $1,000 in fines and they will both be liable for $6,200 cost of prosecution. They must also file accurate and complete Wisconsin state income tax returns for income years 1977 through 1983 and pay all back taxes, penalties and interest.

Mr. Beck was charged with failing to file state income tax returns for 1980, 1981 and 1982 and Mrs. Beck was charged with failing to file returns for 1981 and 1982. They were found guilty on all counts after trial before a jury on February 19, 1985.

A Manitowoc County man has been ordered to serve one year in jail for criminal violations of the Wisconsin state income tax law. Leon L. Nielsen was sentenced in Manitowoc County Circuit Court, Branch 1, by Circuit Judge Allan J. Deehr on three counts of failing to file Wisconsin state income tax returns after he was tried and found guilty on all counts by a jury. Nielsen was charged with failing to file state income tax returns on gross income of more than $24,000 for 1981, $27,000 for 1982 and $29,000 for 1983.

NEW ISI&E DIVISION RULES AND RULE AMENDMENTS IN PROCESS

Listed below, under Part A are proposed new administrative rules and amendments to existing rules that are currently in the rule adoption process. The rules are shown at their stage in the process as of July 1, 1985. Part B lists rules that have been adopted but are not yet effective. Part C lists new rules and amendments which have been adopted in 1985.

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

A. Rules at Legislative Council Rules Clearinghouse

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

B. Rules Adopted But Not Yet Effective (Tentative Effective Date is August 1, 1985)

8.51	Labels-A
8.61	Advertising-A
8.76	Salesperson-A
8.81	Transfer of retail liquor stocks-A
11.002	Permits, application, department determination-NR
11.10	Occasional sales-A
11.16	Common or contract carriers-A
11.17	Hospitals, clinics and medical professions-A
11.52	Coin-operated vending machines and amusement devices-A
11.53	Temporary events-A
11.54	Temporary amusement, entertainment, or recreational events or places-A
11.62	Barbers and beauty shop operators-A
11.67	Service enterprises-A
11.68	Construction contractors-A
11.69	Financial institutions-A
11.97	"Engaged in business" in Wisconsin-A

C. Rules Adopted in 1985 (in parentheses is the date the rule became effective)

11.10	Occasional Sales-A (5/1/85)
11.50	Auctions-A (5/1/85)

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

Wendy L. LaBadie
Basis of assets
Robert M. Lawn
Allocation of income
Wayne Schultz, Marjorie Schultz, Wendell Schultz and Daniel Schultz
Penalty - underpayment of taxes

Corporation Franchise/Income Taxes

International Business Machines Corporation
Apportionment
Lake Wisconsin Country Club
Gross income - membership dues
Spacesaver Corporation
Wives' travel expense
United States Steel Corporation
Apportionment
Unitary business

Sales/Use Taxes

Netex Pet Foods, Inc.
Claims for refund
Skycom Corporation
Cable television system services
Valley Ready Mixed Concrete Co., Inc.
Maufacturing exemption

Homestead Credit

Evelyn M. Fillner
Joint ownership
Alice L. Szymczyk
Nursing home resident receiving medical assistance

INDIVIDUAL INCOME TAXES

Wendy L. LaBadie vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, February 12, 1985). The issue in this case is whether or not the taxpayer is required to pay Wisconsin income tax on gain incurred from constant basis assets (namely, her shares of Clark Oil & Refining Corporation stock) occurring during a period of nonresidency.

Prior to January 1, 1978, Wendy LaBadie was domiciled in and a resident of Wisconsin. From January 1, 1978 through August 31, 1980, the taxpayer was not domiciled in and was not a resident of Wisconsin. On September 1, 1980, she reestablished her Wisconsin domicile and residence.

Prior to January 1, 1965, the taxpayer acquired 58,936 shares of common stock of Clark Oil & Refining Corporation, a Wisconsin corporation ("Clark stock"), by gifts on various dates. The aggregate fair market values of these shares on the various dates she received them totalled $62,894.32. The aggregate fair market value of these shares on December 31, 1977 and September 1, 1980 was $360,983 and $1,312,246.85, respectively.

During the period January 1, 1965 through December 31, 1977, the taxpayer acquired 7,408 shares of Clark stock by gifts on various dates. The aggregate fair market value of these shares on December 31, 1977 and September 1, 1980 was $45,374 and $164,943.75, respectively.

During the period January 1, 1978 through August 31, 1980, the taxpayer acquired 1,054 shares of Clark stock by gifts on various dates. The aggregate fair market value of these shares on September 1, 1980 was $23,467.97.

On September 18, 1981, Wendy LaBadie sold her 67,398 shares of Clark stock on the installment basis with 5% of the purchase price being paid in 1981 and the balance thereafter. For federal income tax purposes the basis of these shares was $5,391.84. The aggregate purchase price for these shares was $2,493,726 or $37 per share. She received payment of $124,686.30 of the total purchase price in 1981 and reported $124,387.05 as capital gain taxable in 1981 for federal income tax purposes.

The taxpayer's original 1981 Wisconsin income tax return reported her 1981 installment gain on the sale of the 67,398 shares of Clark stock as $124,387.05, basing her Wisconsin basis for the shares on her federal adjusted basis in order to determine the amount of the 1981 Wisconsin taxable capital gain. She filed her original 1981 Wisconsin income tax return and paid the $16,571.31 Wisconsin income tax shown on or before April 15, 1982.

Wendy LaBadie filed an amended Wisconsin income tax return on January 14, 1983 claiming a refund of $5,762.15 in Wisconsin income tax due to Wisconsin basis adjustments to the 67,398 shares of Clark stock aggregating $57,621.46 for 1981 as follows:

A. 58,936 shares acquired prior to Janaury 1, 1965.

(i)

Aggregate fair market value of shares on date of gifts	$ 62,894.32
Less: federal basis of shares	(4,682.52)
Wisconsin basis adjustment	58,211.80
Percent of basis recovered in 1981	5%
1981 Wisconsin basis adjustment	2,910.59
Reduction in 1981 reported Wisconsin capital gain	$ 2,910.59

(ii)

Fair market value of shares on September 1, 1980	$1,312,246.85
Less: Fair market value of shares on Dec. 31, 1977	(360,983.00)
Wisconsin basis adjustment	951,263.85
Percent of basis recovered in 1981	5%
1981 Wisconsin basis adjustment	47,563.19
Reduction in 1981 reported Wisconsin capital gain	$ 47,563.19

B. 1,054 shares acquired January 1, 1978 - August 31, 1980.

Fair market value of shares on September 1, 1980	$ 23,467.97
Less: federal basis of shares	(84.32)

Wisconsin basis adjustment	23,383.65
Percent of basis recovered in 1981	5%
1981 Wisconsin basis adjustment	1,169.18
Reduction in 1981 reported Wisconsin capital gain	$ 1,169.18

C. 7,408 shares acquired January 1, 1965 - December 31, 1977.

Fair market value of shares on September 1, 1980	$ 164,943.75
Less: fair market value of shares on December 31, 1977	(45,374.00)
Less: federal basis of shares	(592.64)
Wisconsin basis adjustment	119,569.75
Percent of basis recovered in 1981	5%
1981 Wisconsin basis adjustment	5,978.48
Reduction in 1981 reported Wisconsin capital gain	$ 5,978.48

By notice of refund dated April 14, 1983, the department allowed the Wisconsin basis adjustments and reductions in the taxpayer's reported 1981 Wisconsin capital gains set forth in paragraphs *A(i)* and *B* of this stipulation. The department denied the Wisconsin basis adjustments and reductions in her reported Wisconsin capital gains set forth in paragraphs *A(ii)* and *C* of this stipulation. The department based this denial upon the conclusion that gain incurred from the appreciation of constant basis assets during a period of nonresidency may not be excluded from Wisconsin taxable income if the assets were acquired while the taxpayer was a resident of Wisconsin.

The Commission held that a Wisconsin taxpayer who purchased and sold corporate stock, while a resident of Wisconsin, may not exclude from the computation of taxable gain realized from the sale appreciation on the stock which occurred during a period of nonresidence.

The taxpayer has appealed this decision to the Circuit Court.

Robert M. Lawn vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, March 26, 1985). The sole issue for the Commission to determine is whether a wage settlement of $8,234.78, received in 1981 as a result of a lawsuit commenced in Florida involving wages owed in 1977 and 1978, is income for Wisconsin tax purposes.

During 1981, Robert M. Lawn, a cash basis taxpayer, was a resident of Wisconsin. In 1981, the taxpayer received payment of $8,234.78 as a result of a settlement of a legal action for payment of wages owed by Logistic Services, Inc. The taxpayer did not declare this payment as income on his 1981 Wisconsin tax return. The taxpayer contends that since the wages were earned while a resident of Florida, but not received until a resident of Wisconsin, the amount is not includable as income in his 1981 return.

The Commission held that all income of resident individuals shall follow the residence of the individual. A wage settlement received in 1981, but earned in 1977 and 1978, is income in the year of receipt to a cash basis taxpayer.

The taxpayer has not appealed this decision.

Wayne Schultz, Marjorie Schultz, Wendell Schultz and Daniel Schultz vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, March 21, 1985). The taxpayers are objecting to the imposition of the underpayment penalty.

All four of the taxpayers were Wisconsin residents during 1981 and shareholders in Schultz Farms, Inc., a Subchapter S corporation.

By March 1, 1982, all four taxpayers filed their 1981 Wisconsin income tax returns reporting undistributed taxable income of Schultz Farms, Inc. and making full payment of taxes due. In addition, the taxpayers reported salary and interest received from Schultz Farms, Inc. The taxpayers did not file quarterly estimated tax returns and payments to Wisconsin during 1981. The department issued a Notice of Penalty for Underpayment of Estimated Tax for the year 1981 against the taxpayers.

The taxpayers object to the imposition of penalties for underpayment of estimated tax on the grounds that they are farmers within the meaning of s. 71.21(3), Wis. Stats., and that, therefore, they should be entitled to the special filing provisions for farmers under s. 71.21(8), Wis. Stats. The taxpayers argue that by filing their 1981 Wisconsin returns by March 1, 1982, they had complied fully with s. 71.21(8), Wis. Stats., and should not have been assessed any penalties.

The Commission held that for purposes of s. 71.21(3), Wis. Stats., neither a farm employe receiving wages nor a Subchapter S shareholder receiving undistributed income treated as dividends from the corporation, even though the corporation may be engaged exclusively in farming, qualifies as a farmer to be entitled to special treatment under s. 71.21(8), Wis. Stats. The income received by the taxpayers both as wages and as undistributed income from Schultz Farms, Inc. was not subject to the provisions of ss. 71.21(3) and (8), Wis. Stats., for purposes of estimated tax reporting requirements. The department acted properly in imposing the penalties for underpayment of estimated taxes for the year 1981.

The taxpayers have not appealed this decision.

CORPORATION FRANCHISE INCOME TAXES

International Business Machines Corporation vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, May 9, 1985). International Business Machines Corporation (IBM), is and was at all relevant times incorporated under the laws of the State of New York and had its corporate headquarters in Armonk, New York.

The issues in this case are as follows:

A. Whether dividends received by IBM, from its subsidiary, IBM World Trade Corporation, constitute apportionable income, subject to taxation in Wisconsin.

B. If IBM's dividends from IBM World Trade Corporation are taxable by Wisconsin, then whether they are includable as "total sales" in the sales factor of the apportionment formula.

C. Whether investment income received by IBM is subject to apportionment and taxation in Wisconsin.

D. If IBM's investment income is subject to taxation in Wisconsin, then whether the interest and proceeds from the sales of investments are includable as "total sales" in the sales factor of the apportionment formula.

E. Whether royalties received by IBM are includable in the sales factor of the apportionment formula.

F. IBM also raises objections to the department's action on constitutional grounds.

On June 6, 1978, the Wisconsin Department of Revenue gave IBM notice of assessment of additional franchise tax for the calendar years 1973, 1974 and 1975, in the amount of $736,935.09, consisting of $606,779.01 tax and $130,156.08 interest. IBM petitioned for redetermination of the assessment. On March 29, 1979, the department gave IBM notice that the petition for redetermination was denied.

On January 11, 1980, IBM filed with the department a claim for refund of franchise taxes paid by IBM for the calendar years 1973, 1974 and 1975 in the amount of $32,769.32, plus interest. On February 1, 1980, the department gave IBM notice that the claim for refund was denied. IBM has appealed from this denial of its petition for redetermination and its claim for refund.

IBM owns and at all relevant times owned all the issued and outstanding stock of World Trade. World Trade is and was at all relevant times incorporated under the laws of the State of Delaware. During the calendar years 1973, 1974 and 1975, World Trade's regular trade and business was similar to that of IBM, except that World Trade operated outside the United States.

During the calendar years 1973, 1974 and 1975, IBM's business activity included the development, manufacture, sale, rental and service of data processing and office equipment. IBM maintained marketing branch offices in each state and manufacturing facilities in many states. It had no manufacturing facilities in Wisconsin. As part of IBM's unitary business, IBM performed substantial research and experimental activities regarding data processing and office equipment. These activities resulted in a substantial number of patents. IBM licensed World Trade, as well as other parties that are unrelated to IBM, to use these patents in their business operations. In exchange, IBM received royalty payments, and in some cases, cross-licenses to use the licensees' patents. As part of IBM's unitary business, IBM also owned and leased a substantial number of office buildings, plants, laboratories and other office space throughout the United States. In many cases, IBM was unable fully to utilize all of the space it owned or leased. IBM then leased this unused space to others.

IBM received royalty income of $156,012,595.02 for 1973, $181,537,206.13 for 1974, and $222,296,167.39 for 1975. IBM treated this income as subject to apportionment under s. 71.07(2), Wis. Stats., on its Wisconsin corporate franchise tax returns. IBM included this income in the sales factor. The department treated the royalties as income subject to apportionment, but excluded the royalties from the sales factor. The department's position is that, even though the royalties are business income, they must be excluded from the sales factor of the apportionment formula, because they are not derived from IBM's "mainstream" or "principal business".

IBM received rental income from real estate of $12,678,016.13 in 1973, $17,403,041.19 in 1974, and $21,098,060.28 in 1975. IBM treated this income as apportionable under s. 71.07(2), Wis. Stats., on its Wisconsin corporate franchise tax returns. IBM included this income in the sales factor. The department treated the rentals as income subject to apportionment, but excluded the rentals from the sales factor.

During the calendar year 1975, IBM owned and administered an investment portfolio which in 1975 had a value in excess of $3.6 billion and made substantial investments in various money market instruments. IBM's investment portfolio was managed by IBM's Investment Department, whose sole function and responsibility was to manage these assets. The Investment Department was headed by a professional portfolio manager, who was hired from the investment community specifically for portfolio management. Other personnel in the department were hired from the investment community. The employes of the Investment Department were located at IBM's corporate headquarters at Armonk, New York. The placing of buy and sell orders for securities originated at that location. The securities in the investment portfolio were physically kept at Banker's Trust Company, 16 Wall Street, New York, New York. All funds relating to the purchase and sale of such securities were channeled through Banker's Trust Company.

The investment policy applied by the Investment Department was one of safety and liquidity. Within these constraints, its goal was to obtain the most attractive return possible. The portfolio composition has consistently been in U.S. Treasury, government guaranteed, tax exempts, certificates of deposit, and investment grade non-government securities. As part of the goal of maximum safety, the Investment Department also maintained adequate diversification as to type of securities, maturity and credit. In managing a fixed income portfolio, the security selection was based on several criteria: (a) expectations regarding the direction of interest rates; (b) maintenance of a prudent security mix and maturity structure; (c) relative value as determined by yield relationships; and (d) forecast of future cash needs. Because of IBM's investment policy, the Investment Department has been limited to the type of securities it has been able to purchase in the open market. IBM's investment in short-term or long-term securities was dictated by financial market and economic conditions.

During 1975, IBM received net interest income of $211,989,098 and capital gains of $16,238,950 as a result of its portfolio investments. IBM treated this income on its Wisconsin corporate franchise tax return as nonapportionable income. The department treated this income as subject to apportionment under s. 71.07(1m), Wis. Stats.

During the calendar year 1975, IBM held investments in subsidiary corporations. IBM owned all the issued and outstanding stock of World Trade. Effective January 1, 1950, IBM transferred to World Trade all of IBM's foreign net assets, IBM's securities of foreign subsidiaries and branches, and IBM's advances to foreign subsidiaries and branches, exclusive of foreign patents under which World Trade was granted a nonexclusive license. The objective of this transfer of assets from IBM to World Trade was to expand sales, service and production outside of the United States. In 1950, World Trade was doing business in 65 countries.

Because of its size and scope, World Trade developed a management philosophy of building strong responsive organizations at the country level. These organizations (branches, subsidiaries and agencies) were coordinated through policies and guidelines, and supported by a technological capability which develops standard products to meet the needs of international markets. World Trade's business quadrupled from 1951 to 1957 necessitating an organizational realignment with particular emphasis on delegation and decentralization of authority for on-the-spot decision making. The realignment divided overseas operations into five major geographical areas: Europe, Latin America, Asia Pacific, South Africa and Canada. Each area was covered by a separate staff organization reporting to an area general manager.

The European Area was typical of the new plan. The area general manager provided advice and counsel for the activities of the European Area. Six regional managers reported to him. Four of the regional managers also served as general managers of the largest countries. The other two regional managers were responsible for several countries, and these country general managers reported to the regional manager. Within each country in which World Trade did business was a World Trade country organization. In most cases the organization was a subsidiary of World Trade. In some cases it was a branch of World Trade. In either case it was the single operating entity for that country with full operational responsibility. The country manager was responsible for setting coordinated policies, salaries, benefits, management development program, training, customer satisfaction and day-to-day operating decisions. The country manager also prepared initial operating plans and budgets. Their principal contact was with the World Trade area headquarters. The staff organization in Europe consisted of specialists in their respective fields, and provided closer counsel for country managers than was possible from World Trade headquarters. The major staff members, reporting directly to the area general manager, were the director of marketing services, the director of finance, the director of manufacturing services and the director of personnel.

One of the important provisions of the new plan was the projection of daily operational responsibility and authority to the field. As a result, the five area general managers reported directly to the president of World Trade. To strengthen further the teamwork concept and allow greater decentralization of authority, a functional staff was organized at World Trade. The staff, specialists in their respective fields, functioned as a long-range planning group to counsel and advise the president on matters of a corporate nature and on plans and programs for specific areas of the business. The functional staff did not enter into the day-to-day operating decisions of the various areas and countries. The headquarters staff informed the president of all developments in all areas and disseminated information.

From 1957 to 1974, several modifications in the organizational structure became necessary. However, the underlying principle of geographical decentralization continued as a cornerstone throughout and the modifications up to 1974 consisted of a variety of consolidations and separations within and among area groups.

In 1974, World Trade, in order to further decentralize its management of overseas operations, transferred all of its foreign net assets (except royalty agreements between World Trade and its foreign subsidiaries) and investments in subsidiaries to two newly created corporations in exchange for all of their capital stock. The two corporations were IBM World Trade Europe/Middle East/Africa Corporation and IBM World Trade Americas/Far East Corporation. And as their names suggest, the assets were divided along the already established geographic areas of World Trade operation. IBM World Trade Europe/Middle East/Africa is responsible for IBM operations in approximately 80 countries and IBM World Trade Americas/Far East is responsible for approximately 45 countries.

During the calendar year 1975, IBM received $350,000,000 in dividends from its investment in World Trade. IBM excluded the dividends from apportionable income on its Wisconsin returns. The department treated the dividends as income subject to apportionment under s. 71.07(1m), Wis. Stats.

As and for additional Findings of Fact, the Commission hereby finds and decides as follows:

1. IBM's data processing and office equipment business is conducted in 128 countries. Its business outside the United States is conducted through IBM World Trade Americas/Far East Corporation and IBM World Trade Europe/Middle East/Africa Corporation, wholly owned subsidiaries of IBM World Trade Corporation, a wholly owned subsidiary.

2. IBM World Trade obtained licenses from IBM for the use of IBM's patents. Any company of IBM may use any patent developed by IBM, assuming an appropriate royalty is paid.

3. IBM World Trade marketed its products in foreign countries. There was a national organization in each country where World Trade operated. The legal form was either a subsidiary incorporated in that country or a branch of the operating company or, occasionally, IBM World Trade itself.

4. Products sold by IBM World Trade were manufactured abroad to meet local specifications.

5. The volume of business done by IBM World Trade was entirely independent of the volume of business done in IBM's domestic data processing and office equipment business.

6. IBM World Trade, through its subsidiaries and branches, manufactured, sold or leased and serviced its data processing and office equipment products in foreign countries.

7. IBM World Trade had extensive manufacturing facilities abroad in all major and many middle-sized countries.

8. Marketing and servicing of IBM World Trade products was organized as a national effort — on the customer's premises and in the customer's language.

9. Within the IBM World Trade structure, day-to-day management was at the national level.

10. Within IBM World Trade, personnel decisions, credit terms, billings and collections, advertising,

labor relations, banking relations, compensation of employes and payroll activities, payments to vendors, accounting, employe benefit plans, tax return preparation and financing of plant expansion were all done primarily on the national level.

11. In Poughkeepsie, New York, the Field Engineering Division operates a new Field Systems Performance Control Center which serves all IBM customers.

12. In IBM's annual reports IBM's employes are presented in terms of its worldwide operations.

13. IBM's financial statements are presented in terms of its worldwide operations.

14. The members of the Board of Directors of IBM World Trade Corporation are elected by IBM. The IBM World Trade Corporation Board of Directors includes several officials of IBM. Some officers of IBM are also officers of IBM World Trade Corporation.

15. There is a direct beneficial relationship between IBM's worldwide business and its total employment in the United States.

16. The IBM 3600 finance communications system was developed to serve the world market of financial institutions. This system was engineered to deal with variations in electrical power, currencies and language among countries. Significant help was obtained from IBM marketing people brought in from all the major banking countries.

17. Two-year operating plans for IBM World Trade are reviewed, analyzed, etc., by IBM top management and then approved.

18. The hiring of people holding senior positions in IBM World Trade receive the approval of IBM's top management.

19. Excess funds generated by IBM World Trade are advanced to IBM and managed by IBM.

20. The operations of IBM World Trade Corporation are part of IBM's worldwide integrated business.

21. IBM's overseas operations have supported approximately one out of five of IBM's U. S. manufacturing jobs.

22. IBM's Research Division has laboratories devoted to basic scientific studies in Yorktown Heights, New York; San Jose, California; and Zurich, Switzerland.

23. Most IBM products are both leased and sold throughout IBM's worldwide marketing organizations.

24. IBM Business Conduct Guidelines, translated into numerous languages, are distributed to employes throughout the world.

25. Before a new product is put on the market for sale anywhere in the world, it must receive the approval of IBM's top management.

26. Expenditures for plant expansion anywhere in the world in excess of two million dollars must have the approval of IBM's top management.

27. In addition to patent rights, IBM World Trade uses IBM's know-how and technology, all of which is made available to IBM World Trade.

28. There are transfers of key personnel between IBM and IBM World Trade.

29. No IBM operating unit is wholly self-sufficient; there are interdependencies at every level throughout IBM's worldwide operations. Each unit draws upon the resources of the worldwide organization.

30. The principal office of IBM World Trade Corporation is in White Plains, New York. IBM's corporate offices were located in Armonk, New York.

31. IBM's investment portfolio was developed from excess money generated by IBM's unitary business operations, including the sale and rental of data processing equipment and office machines, and earnings (dividends) from IBM's unitary worldwide business operations.

32. Excess money generated by IBM's U.S. business operations was transferred from local collection banks to a New York bank, Banker's Trust. The funds from various sources were commingled. Banker's Trust was the custodian of IBM's investment portfolio.

33. The investment portfolio was shown as a current asset on IBM's balance sheet.

34. Income earned by the investment portfolio was not in any way related to the sale of IBM products.

35. Changes in the maturity structure of the investment portfolio were in response to changes in market conditions and not in response to any need of IBM's business operations.

36. When funds were drawn out of the investment portfolio, this was done by the IBM corporate cash management group, a department separate and distinct from the investment portfolio management.

37. The director of the investment portfolio, an employe of IBM, reported within the company to the director of cash management and planning, who in turn reported to the treasurer of IBM.

38. IBM's investment portfolio generated profits totally separate and apart from the data processing and office equipment business of IBM.

39. No required ratios were imposed by IBM management on the investment portfolio. IBM relied upon professional portfolio managers to optimize investment income. The maturity distribution and security mix were determined by the portfolio manager.

40. The investment portfolio department was a separate profit center, treated separately for accounting purposes, and had no involvement with operating divisions of IBM in day-to-day operations.

41. IBM's investment portfolio was apparently the largest corporate portfolio of any industrial company in the world, and exceeded the portfolio of all but the largest one or two banks in the U.S.

42. IBM treated the income from the investment portfolio as allocable to New York State. IBM's portfolio investment business was managed solely within the State of New York.

43. The investment portfolio department was located at IBM's corporate headquarters in Armonk, New York. All orders to buy and

sell securities originate there. Securities were physically kept at Banker's Trust, a New York bank.

44. Money from IBM's investment portfolio is used by IBM for plant expansion, working capital or any other business purpose designated by IBM management.

45. In its 10-K report to the Securities and Exchange Commission and in its annual reports to stockholders, IBM does not show its investment portfolio as a separate activity.

46. IBM's investment portfolio is not a discrete business enterprise, unrelated to its unitary business.

47. The investment portfolio department had no bank accounts or bank dealings in Wisconsin and the department enjoyed no benefits or privileges under Wisconsin law.

48. IBM's royalties were derived from an integral part of its unitary data processing and office equipment business. The royalties are in the mainstream of IBM's business. Its research and experimental efforts developed technology which IBM used to manufacture products itself and to license others to manufacture products.

49. The data processing and office equipment business (including the business which generates royalties) functioned as a single unit. The portion of the data processing and office equipment business which generated royalties depended on and contributed to the operation of the remainder of the data processing and office equipment business.

50. IBM was in a high technology business. The creation, use and licensing of patents, trademarks, technical know-how and similar assets were inseparable from IBM's data processing and office equipment business.

51. Within the IBM corporate structure, research and development activities were organized on the divisional level. The division headquarters were in Yorktown Heights, New York, where over 1,000 scientists were employed. Research findings were transmitted to developmental laboratories (IBM had approximately 18 such laboratories) where new products were developed.

52. Research and development activities and sales of patents and IBM products were part of a continuous cycle. Ongoing research and development activities produced new technology, which resulted in new patents. The patents were used to produce new products and were licensed to other companies, which produced revenue. The revenue was reinvested in additional research and development.

53. The manufacturing divisions of IBM had an ongoing dependency on technological development. Developmental laboratories were located at the manufacturing plants.

54. Products on which patents were obtained were developed for use in IBM's regular business operations.

55. Research and development expenses, including salaries and the cost of securing and protecting patents, were treated as part of IBM's regular business operations.

56. IBM spent the following amounts for research and development: $730 million in 1973, $890 million in 1974 and $946 million in 1975.

57. Any competitor of IBM may license any patent developed by IBM, assuming an appropriate royalty is paid. In addition to licensing patents in exchange for royalties, IBM entered into hundreds of cross-licensing agreements with competitors and others during the 1973-1975 period.

58. The payment of royalties from IBM World Trade to IBM, as well as from other companies to IBM, were arm's length transactions motivated by a business purpose.

The Commission concluded:

A. IBM World Trade Corporation is not a "discrete business enterprise" but rather an integral part of IBM's worldwide unitary business.

B. Dividends received by IBM in 1975 from its subsidiary, IBM World Trade Corporation, are includable in its apportionable income and are subject to taxation by the State of Wisconsin within the intent and meaning of s. 71.07(1m), Wis. Stats.

C. The dividends received by IBM from IBM World Trade Corporation are includable as "total sales' in the sales factor of the apportionment formula within the intent and meaning of s. 71.07(2)(c), Wis. Stats.

D. During the period involved, IBM's business within Wisconsin was an integral part of its unitary business within the intent and meaning of s. 71.07(2), Wis. Stats.

E. The investment department of IBM is not a "discrete business enterprise" but rather an integral part of IBM's unitary worldwide business.

F. Investment income received by IBM during the period involved is includable in its apportionable income and is subject to taxation by the State of Wisconsin within the intent and meaning of s. 71.07(1m), Wis. Stats.

G. The interest and proceeds from the sale of investments by IBM during the period involved are includable as "total sales" in the sales factor of the apportionment formula within the intent and meaning of s. 71.07(2)(c), Wis. Stats.

H. The royalties received by IBM during the period involved constituted "mainstream" income and are includable as "total sales" in the sales factor of the apportionment formula within the intent and meaning of s. 71.07(2)(c), Wis. Stats.

I. The Commission does not have the authority or jurisdiction to rule on the constitutional issues raised by IBM.

The taxpayer has appealed this decision to the Circuit Court. The department has not appealed this decision.

Wisconsin Department of Revenue vs. Lake Wisconsin Country Club (Court of Appeals, District IV, February 25, 1985). Lake Wisconsin Country Club appealed a judgment of the Circuit Court overturning part of a Tax Appeals Commission decision which determined that assessments for Lake Wisconsin's capital improvement fund were taxable income rather than nontaxable contributions to capital. (See WTB #37 for a

summary of the Circuit Court's decision.)

Prospective members of Lake Wisconsin Country Club must purchase a $100 Certificate of Membership which is refunded when they withdraw, pay a nonrefundable initiation fee of $100 and pay nonrefundable annual dues and assessments for capital improvements. The club contended that the assessments constitute contributions to capital and so do not fall within the statutory definition of income.

The Court of Appeals concluded that there is a reasonable distinction between contributions to capital and income, and that the Commission's conclusion that that distinction is embodied in s. 71.03(1), Wis. Stats., is a reasonable conclusion. The Court of Appeals therefore need not examine competing interpretations of s. 71.03(1). The judgment of the Circuit Court is reversed.

The department has appealed this decision to the Supreme Court.

Spacesaver Corporation vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, February 12, 1985). During the period under review, 1977 through 1981, Spacesaver Corporation was a Wisconsin corporation with its principal place of business in Fort Atkinson, Wisconsin. The sole issue for the Commission to determine is whether or not the travel and business meeting expenses for employes' wives were "ordinary and necessary" business expenses of the taxpayer and were deductible under s. 71.04(2)(a), Wis. Stats.

The taxpayer is involved in manufacturing, engineering and marketing high density shelving. The vast majority of sales of its product are made through franchised area contractors in the United States and Canada. The area contractors are independently owned companies, ranging from three to thirty people.

The taxpayer planned and hosted the annual sales conferences which were held either the last week of February or the first week of March. The annual sales meetings were typically held in Arizona and Southern California because the climate was conducive to the recreational activities the taxpayer had planned. The purposes of the annual sales meetings were to market the taxpayer's product, to introduce new products, and to decide the theme for the next annual sales meeting.

The marketing, sales and customer service personnel attended the annual sales meetings, as well as the officers of the company, and on occasion a senior engineer and the company's legal counsel. The wives of the employes of Spacesaver started accompanying their husbands to the annual sales conferences in 1977.

The wives of the employes did not perform any administrative functions in the taxpayer's corporation; they were not shareholders and corporate officers of the corporation; they could not enter into contracts for the corporation, and they were not salespersons hired by the corporation. Additionally, the wives of the taxpayer's employes had no educational background or work experience in the areas of sales and marketing.

The taxpayer claims that the purpose of having the wives of its employes attend the annual sales conference was to motivate the area contractors' wives to motivate their husbands to sell the taxpayer's products and to promote a certain family image. The employes' wives also participated in a variety of activities such as assembling literature packets, assembling hardware displays, assisting in registration of participants, assisting in room reservations, acting as table hostesses, assisting in audiovisual presentations, and hostessing ladies' programs.

The taxpayer's annual sales conference agendas for the years 1977 through 1981 had two separate programs, one for the business sessions and the other for the ladies' optional programs. A majority of the ladies' programs consisted of social and recreational activities.

The Commission concluded that a substantial percentage of the business activities for the employes' wives were social and recreational and the incidental services performed by the wives of the employes did not constitute a bona fide business purpose. The travel and business meeting expenses for employes' wives were not "ordinary and necessary" business expenses of the taxpayer and were not deductible under s. 71.04(2)(a), Wis. Stats.

The taxpayer has appealed this decision to the Circuit Court.

United States Steel Corporation vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, May 9, 1985). The taxpayer has raised a number of issues in this appeal. The first issue raised relates to the "unitary business/formula apportionment" concept of allocating income to Wisconsin for taxation purposes. It is the taxpayer's contention on the unitary issue that its transportation operation is not part of its unitary business in Wisconsin because this activity is carried out through subsidiaries which did no business in Wisconsin. In addition, the taxpayer is contending that three of its divisions, USS Realty Development (Realty), Sterling Park Development Division (Sterling Park) and the New York Investment Division (Investment Division), were not part of its unitary business in Wisconsin.

The taxpayer raises the following issues in addition to the above-stated contention on the unitary issue:

A. Whether the department's method of determining apportionable income relating to its mining operations was arbitrary, in violation of the principle of the Wisconsin statutory three factor approach to apportionment, and/or in violation of the statutory pattern in s. 71.07, Wis. Stats., for determining apportionable income by shifting further emphasis in the formula to sales and away from property and payroll.

B. Whether the department erred in including the taxpayer's intangible income in apportionable income.

C. Whether all intangible proceeds from the sales, exchanges and redemptions of intangible assets should be included in the taxpayer's gross receipts for the purpose of calculating the denominator of the sales factor on the taxpayer's 1975 return.

D. Whether the property, payroll and sales of the taxpayer's dividend paying subsidiaries should have been included in the denominators of the property, payroll and sales factors for purposes of calculating intangible income apportionable to Wisconsin.

E. Whether Wisconsin's double weighted sales factor results in attributing to Wisconsin income

out of all appropriate proportion to the activities of the taxpayer in Wisconsin; results in multiple state taxation or results in attributing to Wisconsin, for taxation, income on Wisconsin destination sales which has already been taxed in the state where the manufacturing was performed; and/or results in a discrimination against interstate commerce.

F. Whether the increase in the relative tax burdens on the taxpayer from the law changes incorporating destination sales, double weighted sales and intangible income into the apportionment calculation constitutes a burden on interstate commerce, and/or whether this increased burden has any rational relationship to the activities of the taxpayer in Wisconsin.

United States Steel Corporation is a Delaware corporation, with its main corporate headquarters in Pittsburgh and New York. It has commercial domicile in Pennsylvania. The taxpayer is a multi-state, multi-national corporation doing business in all but one of the United States and numerous foreign countries.

There are five major segments comprising the taxpayer's domestic operations; each segment is made up of several divisions. The five major segments are as follows: manufacture and sale of steel, fabricating and engineering, chemicals, transportation, and cement.

In addition to the above segments, the taxpayer has other miscellaneous operations, including Realty, Sterling Park, and the Investment Division. These operations are conducted as divisions of the taxpayer and are not subsidiary corporations.

The taxpayer owns the following subsidiaries: twelve railroad subsidiaries, Orinco Mining Company, U.S. Steel International, United States Steel International Sales Co. (DISC), Intupersa, Navigen Company, and Navios Corporation.

The taxpayer is a stockholder with less than a controlling interest in the following dividend paying corporations: Ashco, Inc.; Oglebay Norton Company; Rinker Materials Co., Inc.; Structural Dynamics Research Corporation; and Altos Hornos de Vizcaya, S.A.

The five divisions of United States Steel Corporation operating in Wisconsin during the relevant period were (a) USS Division - production and sales of steel; (b) USS Supply Division - warehouses for sale of steel products; (c) USS Chemicals Division - manufacture of various industrial chemicals; (d) Universal Atlas Division - production and sale of cement products; and (e) USS Agri-Chemicals Division - manufacture of various nitrogen phosphatic fertilizer products.

The taxpayer is not asserting that its income relating to the activities of four of its major segments (manufacture and sale of steel; fabrication and engineering; chemicals; and cement) is not subject to apportionment in Wisconsin in that each of these divisions had activities in Wisconsin during the years at issue.

Each division of the taxpayer is run as a separate profit unit, operating under the principle of "functional profitability independence". Each division has a separate set of books and records and a separate profit and loss statement. Each division is headed by an executive officer, hired and fired by the taxpayer's top level management. Each division determines how best to accomplish its goal of making a profit, with each unit having responsibility for getting a rate of return competitive with what outside businesses in the same line are earning.

Each division has its own sales, advertising, personnel, accounting, etc., departments. However, the division may rely on the taxpayer's central office to provide assistance in purchasing, accounting, personnel, legal matters, tax problems, etc. There is no requirement that the divisions utilize these services (they may go outside), and the divisions are charged for these services at market rates. These charges are taken against the division's profit and loss statement. Intra-company transactions are conducted at arm's length.

Certain services of the central office benefit the entire company, e.g., lobbying on environmental or labor matters, public relations, pension and employe insurance plans, corporate-wide self-insured coverage, labor negotiations, transportation planning, safety practices, planning for future facilities, economic studies, centralized and uniform accounting system, research and development, central computer system, and advertising of a corporate image type. The taxpayer's central tax department is responsible for preparation of tax returns, state and federal. Each division is responsible for preparation of its own financial statements, which are submitted to the central office for consolidation for Securities and Exchange Commission (SEC) reporting and the annual report. On occasion, the taxpayer's employes are transferred between divisions for further training. The steel and raw materials divisions are coordinated to a great extent through the central office. The taxpayer has a vice-president of Accounting-Other Divisions whose responsibility is to work with divisions other than steel and raw materials to make sure that the taxpayer has the coordination and uniformity necessary to carry out its programs and policies.

If a division is in need of funds for expansion, the head of the division would look to the taxpayer's treasurer, and advances made to a division in excess of its budget would be subject to the discretion of top management.

The head of each division is responsible for preparation on an annual basis of a forecast of profits and losses, a budget and expected rate of return, plus a projection for the next three years, which is reviewed with the next higher level of management. These budgets and forecasts are submitted to the central accounting office for preparation of a company-wide projection, which is approved by the taxpayer's Corporate Policy Committee.

United States Steel Corporation's Board of Directors establishes the overall policies for the taxpayer and approves certain activities, e.g., filings with the SEC, the annual report, major expenditures of the corporation and its dividend policy.

The Corporate Policy Committee is a committee of the Board of Directors whose principal function is carrying out certain policies designated by the Board. It also acts as the primary approval group before going to the Board, and in some cases, the Board has delegated to this committee authority for approval of certain financial matters.

The Corporate Management Committee is a committee of the Board of Directors whose principal functions

are to review the profit and loss results of the divisions, and to review the operating situations of each division. Through this committee, each division keeps top management advised of the status of its business, reporting its results and where it stands in relation to its expectations for the year, and discussing the problems it might be having.

All excess cash of the divisions not needed for day-to-day operations is turned over to the Investment Division, where it is commingled with other business receipts and invested at the discretion of the New York investment staff. Once these funds are commingled, it is impossible to trace the source of the funds.

If funds are needed by the taxpayer's management for expansion, capital acquisitions or acquisitions of new businesses, needed funds are obtained either through borrowing, the corporate treasury, or sales of stock. The decision as to the source of financing is made by top management with approval of the Corporate Policy Committee.

The Investment Division has been in existence since at least the 1930s. Its offices are located in the taxpayer's New York headquarters. This division is under the supervision of the corporate treasurer. Although because of the nature of this operation it has had little need of the taxpayer's central services, the Investment Division operates in relation to the taxpayer's central office in a similar manner to the other divisions.

The main responsibility of the Investment Division is the management and investment of the cash of the taxpayer not needed for the day-to-day operations. The Investment Division is a sizable contributor to the taxpayer's income; in fact, the top money making division of the taxpayer in 1975. The Investment Division is one of the taxpayer's regular business functions.

The Investment Division invests the taxpayer's excess cash in short-term investments (less than 1½ years). These short-term investments are primarily in Treasury bills, notes and bonds; bankers acceptances and bankers participation certificates; certificates of deposits from various banks; commercial paper; and Canadian time deposits. Most of these short-term investments are negotiable instruments and are readily traded and sold by the division. In 1975, the net income from intangibles earned through investments by the Investment Division was $303,871,292.

The Investment Division had one $20,000 certificate of deposit in Wisconsin, which was in the North Milwaukee State Bank, from which the taxpayer derived $1,100 annual interest income. Other than this certificate of deposit, the Investment Division had no activity in Wisconsin; no securities kept in Wisconsin; no other bank accounts in Wisconsin; and no funds transferred for use in Wisconsin.

The Investment Division provides needed cash flow to other divisions of United States Steel Corporation. Normally, the funds can be made available on short notice for use by other divisions or by the taxpayer for acquisitions. When the Investment Division is called upon to provide cash for another corporate purpose, it is for a specific purpose, such as working capital or a loan to a division, as specified through the Pittsburgh office. The Investment Division does provide cash for loans to subsidiaries which are interest bearing notes, usually tied to the prime rate.

Realty was created in 1969 with an initial capital investment from the taxpayer. The head of this division reports to the vice-president of Realty and Finance. The purpose of Realty is to develop and manage corporate property to the best financial advantage, for corporate use and otherwise. It is construction oriented, having constructed shopping centers, industrial parks, warehouses and recreational facilities (e.g., theme hotels for Disney World). Realty constructs warehouses for lease to the taxpayer at market rental rates. On a few occasions, Realty has taken over facilities abandoned by the taxpayer.

Realty operates in relation to the taxpayer's central office in a similar manner to the other divisions. Realty has its own accounting department, financial statements, and management. Realty uses outside engineers because it employs people from the community in which it is operating. Realty does not use the taxpayer's central research and development facilities, engineering department, advertising, labor services or legal counsel (although on a few occasions, it has used the legal services, paying for the service). Realty does have charges included in the Deductions listed on its Operating Statements for 1972-1975 for services provided by other administrative groups of the taxpayer. Realty has used the taxpayer's products in its construction activities. Realty usually obtains financing by borrowing on the outside but has sought financial assistance from the taxpayer. Requests for additional funding are made by Realty's management through the appropriate channels within the taxpayer. The decision is made by the taxpayer's management whether to finance through the taxpayer or go outside.

Realty's excess earnings flow to the taxpayer, which takes control over these funds for use within the discretion of the taxpayer's management.

Realty's accounting personnel are located in the taxpayer's Pittsburgh office building. Other employes of Realty are located throughout the United States. The paychecks are from the USS Realty Division payroll account.

Sterling Park was responsible for a housing development in Sterling Park, Virginia, consisting of single- and multi-family housing which were sold to the general public. It also developed and maintains a shopping center in the area. Prior to 1972, Sterling Park was a subsidiary of the taxpayer and was then changed into a division. It remains a very small division of United States Steel Corporation. Sterling Park operates in relation to the taxpayer's central office in a similar manner to the other divisions. The head of Sterling Park reports to the vice-president of Realty and Finance.

This division developed a warehouse for lease to the taxpayer's products division in Birmingham, Alabama, which was leased on the basis of commercial prices.

Neither Realty nor Sterling Park owns any land in Wisconsin and neither has any operations in Wisconsin.

United States Steel Corporation owns twelve domestic railroad subsidiaries. The taxpayer did not organize any of these railroad companies but acquired existing companies around 1901, when the corporation was organized. These twelve subsidiaries constitute one of the largest carrier systems in the United States

in terms of profits. The taxpayer holds a 100% interest in each of these companies, except for some of the preferred stock of Bessmer & Lake Erie Railroad Co.

In 1975, these railroad companies had approximately $500 million in assets. They owned 2,700 miles of track, 445 locomotives, 32,000 freight cars and had 32,000 employes.

These railroad companies are common carriers, authorized to do business by the Interstate Commerce Commission (ICC) and by various state regulatory agencies. Each company has its own Board of Directors, officers and employes. The companies have common directors and officers (with permission of the ICC), but have no common directors or officers with the taxpayer.

The taxpayer plays no role in management of these companies and would be prohibited from doing so under the ICC. The taxpayer merely acts as a shareholder in these companies, and as such, elects the Boards of the companies.

Each railroad has its own management, financing (each has its own credit line; the taxpayer does not participate in raising capital for any of these companies), and personnel benefits. Its employes are covered under the Railroad Retirement Act and the Railroad Unemployment Act, rather than Social Security and state unemployment plans. There are no common benefits for the employes of the railroad subsidiaries and the taxpayer's employes. These companies receive no management services from the taxpayer, and they do not look to the taxpayer on major policy decisions.

The only capital contribution by the taxpayer of these companies was in 1978 to help finance a new facility for one of the companies.

The ICC requires that these companies remain independent. The ICC sets the rates charged by railroads, sets policies concerning abandonment, and requires a uniform accounting system. These companies are prohibited by law from discriminating in favor of any customer and actively seek customers other than the taxpayer.

The taxpayer has opposed rate increases for railroads. The taxpayer also uses other carriers, such as Conrail. However, a significant amount of the transactions of these railroads involve United States Steel Corporation as the customer (the percentage of sales by the railroads to the taxpayer ranges from 39% to 100% of the railroads' total sales). These transactions are at market rates.

Each railroad company, by its Board of Directors, determines its own dividend after examining the financial situation in a year. The taxpayer has no input into that decision.

In determining the amount of income from the taxpayer's mining operations subject to apportionment, the department's assessment separated net income from mining sales to third parties from total income from mining by using the ratio of sales to third parties to total income from mining, which methodology only considered sales and did not consider the property or payroll involved in the mining function.

Use of the statutory factors of sales, payroll and property to separate income from mining sales to third parties from total mining income shows a reduction in apportionable income of $9,885,876 in 1972, $11,591,610 in 1973, $19,763,010 in 1974, and $24,495,789 in 1975.

In computing the payroll and property factors for the apportionment formula, the department used sales percentages to separate apportionable from nonapportionable payroll and property, which added to the overall impact of sales on the apportionment result.

Intupersa is a small steel fabricating plant located in Guatemala. It made no sales to the taxpayer and utilized local suppliers of raw materials and made all sales in that area. United States Steel Corporation owned a 93% interest in this company. The taxpayer may have had personnel on the Board, and the major policy decisions of Intupersa had to have approval of the taxpayer's Board of Directors.

Orinco Mining Company was a Venezuelan mining company which prior to 1975 was a supplier of iron ore to the taxpayer. The taxpayer had a 100% interest in this company. In 1975, the Venezuelan government expropriated this company's property, as a result of which the taxpayer received a dividend of $115 million representing a return of the taxpayer's capital. Prior to January 1, 1975, the taxpayer had representatives on the Board of Orinco, but after January 1, 1975 the company no longer had any property. In 1975, this company sold its services to the Venezuelan government as mining consultants.

Navios Corporation and Navigen Company are two of the taxpayer's transportation subsidiaries. United States Steel Corporation had a 100% interest in both. They are both Liberian shipping lines. Navios did no business with the taxpayer in 1975. Navigen did provide ocean hauling services for the taxpayer in 1975, but on the same basis as transportation for third parties. These companies had no common officers with the taxpayer and were operated independently and autonomously from the taxpayer.

United States Steel Corporation presented no evidence concerning the operations of U.S. Steel International, Inc. and United States Steel International Sales Company (DISC) to show that these companies were discrete business enterprises.

In addition to its subsidiaries, the taxpayer owns a minority interest in the following dividend paying companies:

A. Ashco, Inc. - Engaged in pumping stations and water pipeline businesses. The taxpayer owns a 35% interest in this company and has some input into its decisions.

B. Oglebay Norton Co. - A large company on the New York Stock Exchange. The taxpayer owns a 3.4% interest in this company.

C. Rinker Materials Co., Inc. - The taxpayer owns an 11.29% interest in this company and has no input except as a shareholder.

D. Structural Dynamics - The taxpayer owns a 45% interest acquired with the proviso that Dr. Jason A. Lemon remain employed with this company for at least five years and that arrangements be made to protect the taxpayer's percentage of participation in the event that new stock is issued.

E. Altos Hornos de Vizcaya, S.A. - A Spanish company in which the taxpayer has a 26.77% interest. The taxpayer made a loan to this company in consideration for

which the taxpayer was to have representation on the Board of Directors for ten years and at least 25% of the voting power of the stockholders, coupled with a change to be made in AHV's by-laws to assure that decisions be made only by a 76% vote. Also under the terms of the agreement, the taxpayer was to provide technical and managerial assistance for ten years.

As to the five companies discussed in the paragraph above, none of them had officers in common with the taxpayer, and there were no purchases or sales between these companies and the taxpayer. The taxpayer has no legal control over these companies.

United States Steel Corporation's total sales in 1975 included its income from intangibles and the proceeds from the sale, exchange and redemption of intangible investments.

There are no published statutory sections, Wisconsin Administrative Code sections, instruction booklets or other materials available to the public which set forth the department's position as was stated in its internal Field Audit Section Bulletin 77-9 that only receipts from "the main thrust of the taxpayer's business" are to be included in calculating the denominator of the sales factor. FASB 77-9 was not promulgated until 2 3/4 years after the 1975 statutory change as to intangible income became effective. The department had proposed an administrative rule which would have provided that for purposes of the calculation of the denominator of the sales factor, the term "sales" only would include those "from the taxpayer's principle business activity". This rule was not enacted, on advice of counsel, because of the potential for problems in litigation.

The taxpayer's total sales in 1975 included its income from intangibles and the proceeds from the sale, exchange and redemption of intangible investments.

The Commission held:

A. The taxpayer's USS Realty Development Division, Sterling Park Development Division and Investment Division were not discrete business enterprises but rather were integral parts of the taxpayer's unitary business during the period at issue. Under s. 71.07(2), Wis. Stats., the taxpayer's business within Wisconsin was an integral part of such unitary business during the period at issue. Therefore, pursuant to s. 71.07(2), Wis. Stats., the taxpayer's income derived from the operations of these divisions, including the intangible income derived from the operation of its Investment Division during 1975, was includable in its Wisconsin apportionable income for the years at issue.

B. The taxpayer's twelve railroad subsidiaries were discrete business enterprises whose activities were unrelated to the taxpayer's activities in Wisconsin. Dividends received by the taxpayer from these subsidiaries are not properly includable in the taxpayer's Wisconsin apportionable income in 1975.

C. The taxpayer's foreign subsidiaries, Orinco Mining Co., Intupersa, Navigen Company and Navios Corporation, were discrete business enterprises whose business activities were unrelated to the taxpayer's activities in Wisconsin. Dividends received by the taxpayer from these foreign subsidiaries are not properly includable in the taxpayer's Wisconsin apportionable income in 1975.

D. The following companies paying dividends to the taxpayer in 1975 were discrete business enterprises whose business activities were unrelated to the taxpayer's activities in Wisconsin: Ashco, Inc.; Oglebay Norton Co.; Rinker Materials Co., Inc.; Structural Dynamics; and Altos Hornos de Vizcaya, S.A. Dividends received by the taxpayer from these foreign subsidiaries are not properly includable in the taxpayer's Wisconsin apportionable income in 1975.

E. Income from intangibles and proceeds from the sale, exchange and redemption of intangible investments received by the taxpayer in 1975 and includable in its 1975 Wisconsin apportionable income come within the intent and meaning of s. 71.07(2)(c)1, Wis. Stats., as "total sales" includable in the denominator of the sales factor.

F. The department's methodology in separating apportionable from nonapportionable income from the taxpayer's mining operations was in error in employing only a sales ratio to the taxpayer's total income from mining and was in error in using a sales ratio to determine apportionable payroll and property. The taxpayer's methodology in determining Wisconsin apportionable income from mining, utilizing sales, property and payroll factors, was shown to be a more accurate calculation and is hereby adopted by the Commission. The department's determination of the taxpayer's Wisconsin apportionable income from mining operations is reduced as follows: 1972 reduced by $9,885,876; 1973 reduced by $11,591,610; 1974 reduced by $19,763,010; and 1975 reduced by $24,495,789.

G. Under Wisconsin law, the taxpayer is not entitled to combine the sales, payroll and property of dividend paying subsidiaries in the denominator of the three factors.

H. The issues raised by the taxpayer in objecting to Wisconsin's imposition of the double weighted sales factor in conjunction with Wisconsin's change to destination based sales reporting and in objecting to the cumulative burden of Wisconsin taxation on the taxpayer's Wisconsin activities resulting from statutory changes (destination sales, double weighting the sales factor and inclusion of intangible income) are constitutional issues, and the Commission lacks authority or jurisdiction to rule on the constitutional issues raised by the taxpayer.

Neither the taxpayer nor the department has appealed this decision.

SALES/USE TAXES

Netex Pet Foods, Inc. vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, January 29, 1985). The sole issue in this case is whether or not Netex is a person who may file a claim for refund of sales tax within the meaning of s. 77.59(4), Wis. Stats.

Netex alleged that it was engaged in the business of manufacturing feed ingredients for sale to other manufacturers of feed. As an alleged man-

ufacturer, the taxpayer may have been entitled to exemption from Wisconsin sales tax on its purchases of machines and specific processing equipment and repair parts, as well as other exemptions.

Netex did not claim all the exemptions that it allegedly was entitled to but rather paid a sales tax to the retailers on its purchase of tangible personal property and taxable services. Netex did not pay any sales tax directly to the department on the items in dispute.

Netex filed a claim for refund and request for sales tax audit for the period June 1, 1977 through May 31, 1981. The department advised Netex that it did not consider this a claim for refund and it would neither grant nor deny the claim because Netex had no sales tax account or consumer use tax account.

The Commission held that the taxpayer was not the "person" required to file, with the department, a sales tax return, reporting the sales tax in question. The taxpayer was not the "person" who paid the sales tax involved to the department within the intent and meaning of s. 77.59(4), Wis. Stats., and thus, has no legal standing to make a claim for refund of sales tax paid.

The taxpayer has not appealed this decision.

Skycom Corporation of Wisconsin, Inc. vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, February 12, 1985). The issues for the Commission to determine are as follows:

A. Are the taxpayer's gross receipts from the rental of parabolic discs to George and Kris Krembs for the Ramada Airport and the Ramada Sands subject to the Wisconsin sales tax under s. 77.52(1), Wis. Stats.?

B. Are the taxpayer's gross receipts for the services provided at Northridge Lake Apartments, Mill Valley Condos, Willow Creek Condos, Chateau Condominiums, and Prospect Towers subject to the Wisconsin sales tax as providing a cable television system under s. 77.52(2)(a)12, Wis. Stats.?

During the period under review, Skycom Corporation owned and leased two parabolic discs to George and Kris Krembs at the Ramada Airport and Ramada Sands on a flat fee basis. Skycom Corporation merely rented the discs at these locations.

Skycom Corporation owned and maintained parabolic discs at Northridge Lake Apartments, Mill Valley Condos, Willow Creek Condos, Chateau Condominiums, and Prospect Towers. The taxpayer also maintained antennas to provide UHF and VHF reception.

Each parabolic disc pulled in microwave signals to allow certain viewers to obtain the movie channel and ESPN, the sports channel. Skycom Corporation did not generate any microwave signals, but amplified microwave signals transmitted by satellites owned by third parties. Skycom Corporation sometimes paid a fee to the owners of the satellites for amplifying its signals.

The parabolic discs were attached to the general wiring system or the master antenna system of a building. The antenna wiring was already in the units and was not installed by Skycom Corporation. Skycom Corporation did not own the master antennas, but maintained the master antennas. The UHF and VHF antennas were not owned by Skycom Corporation but were owned by the homeowner's association or the owner of the apartment buildings. Skycom Corporation never sold or installed UHF or VHF antennas, and this was not part of its service fee.

Skycom Corporation also owned and maintained a decoder block which was a wire from the individual TV set to the wall tap.

The taxpayer charged the individual apartment dwellers or condominium dwellers a monthly fee for the reception of the additional television channels. Not every resident of an apartment complex or condominium served by Skycom subscribed to receive the additional television channels.

The Commission concluded that the taxpayer's gross receipts from its rental of parabolic discs to George and Kris Krembs for the Ramada Airport and the Ramada Sands are subject to the Wisconsin sales tax. The taxpayer's gross receipts for the services provided at Northridge Lake Apartments, Mill Valley Condos, Willow Creek Condos, Chateau Condominiums, and Prospect Towers are subject to the Wisconsin sales tax as providing a cable television system under s. 77.52(2)(a)12, Wis. Stats. Skycom Corporation did not qualify for any exemptions under s. 77.51(28), Wis. Stats.

The taxpayer has appealed this decision to the Circuit Court.

Wisconsin Department of Revenue vs. Valley Ready Mixed Concrete Co., Inc. (Circuit Court of Dane County, May 2, 1985). The issue in this case is whether the Wisconsin Tax Appeals Commission's determination that Valley Ready Mix "manufactured" concrete in its mixer trucks was erroneous as a matter of law. In its decision dated November 13, 1984, the Commission ruled that Valley Ready Mix was entitled to a sales and use tax exemption on the purchase of truck chassis, mixing units and repair and replacement parts used in the company's manufacture of concrete. (See WTB #41 for a summary of the Commission's decision.)

The Circuit Court found that the Commission's conclusion that Valley Ready Mix's operations constituted manufacturing — while reasonable people might reach different conclusions on the same question — is reasonable based on the facts. Thus, the Circuit Court affirmed the Commission's decision.

The department has not appealed this decision.

HOMESTEAD CREDIT

Evelyn M. Fillner vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, January 31, 1985). The issue before the Commission is whether the department correctly adjusted the claimant's 1982 homestead credit claim.

The department adjusted the claimant's 1982 claim because she jointly owned the real estate with Darwin Fillner, her adult son. The department allowed her to claim her share of the taxes plus 25% of the remaining taxes as rent.

The claimant in her petition for redetermination stated that "I owned said property until my son gave me a gift of home improvements such as aluminum siding, screens and windows, ... He had to have half ownership (in name only) to get his loan from the loan company."

The Commission concluded that during the period involved the claimant was deemed to have an ownership interest of only 50% in the homestead in question, as record title was held jointly by her with her adult son. The department acted properly when it adjusted the claimant's 1982 property taxes accrued to 50% of the tax bill on the homestead plus 25% of the remaining 50% of the 1982 tax bill as rent constituting property taxes accrued.

The claimant has not appealed this decision.

Alice L. Szymczyk vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, January 29, 1985). The only issue pending before the Commission is whether the claimant, who resided in a nursing home and received medical assistance under Title XIX at the time she filed her 1983 homestead credit claim, is entitled to a homestead credit refund for 1983.

The claimant filed a 1983 homestead credit claim and attached a real estate tax bill addressed to John Szymczyk at 1901 Hamilton Street, Manitowoc, Wisconsin. The claimant claims that she paid the real estate taxes in 1983.

On December 23, 1983, the claimant entered the Park Lawn Nursing Home. While residing in the nursing home, she received medical assistance under Title XIX. The claimant filed her 1983 homestead claim while a resident of the nursing home.

The Commission held that the claimant is not eligible for homestead credit for 1983 because at the time she filed for the credit she resided in a nursing home and was receiving medical assistance under Title XIX.

The claimant 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. Political Contributions
2. Taxability of Layoff Benefits
3. Taxability of Railroad Retirement Benefits
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Homestead Credit and Farmland Preservation Credit

1. Add Back for Gain on Sale of Principal Residence
2. Farmland Credit for Not-for-Profit Corporation

INDIVIDUAL INCOME TAXES

1. Political Contributions

Statutes: section 71.02(2)(b), 1983 Wis. Stats.

Facts: Taxpayer A contributes a painting to the campaign fund of a political candidate. The painting has a fair market value of $100. The campaign committee immediately sells the painting in a fund raising auction to Taxpayer B for $130.

Question 1: For Wisconsin purposes, may Taxpayer A claim a deduction for a political contribution?

Answer 1: No, Taxpayer A may not claim a deduction for the contribution of the painting. Only contributions or gifts of money may be deducted. Wisconsin follows the federal Internal Revenue Code Section 218, as it existed immediately prior to its repeal in 1978. Section 218 allowed as a deduction any political contribution, which was defined in Code Section 41(c)(1) as "a contribution or gift of money to ...."

Question 2: Are there any tax consequences to Taxpayer A as a result of donating the painting?

Answer 2: Yes, under Section 84 of the Internal Revenue Code, the contribution must be treated as a sale. Taxpayer A is considered to have realized an amount equal to the fair market value of the painting at the time of transfer. If the fair market value exceeds Taxpayer A's basis in the painting, short or long term capital gain is realized. If Taxpayer A's basis is greater than the fair market value, the loss is not deductible.

Question 3: For Wisconsin purposes, may Taxpayer B claim a deduction for a political contribution?

Answer 3: Yes, Taxpayer B may claim a deduction of $30. The fair market value of the painting is $100. If Taxpayer B pays $130 for the painting, Taxpayer B may deduct $30 ($130 purchase price minus the $100 actual value of the asset acquired).

Question 4: If the painting is not immediately resold, how would the political contribution be determined?

Answer 4: The amount of political contribution is dependent upon the fair market value of the painting at the time

of purchase from the political organization. If the amount paid for the painting is greater than the fair market value determined at the time of purchase, the excess is considered a political contribution.

2. Taxability of Layoff Benefits

Statutes: section 71.02(2)(b), 1983 Wis. Stats.

Facts and Question: Under Section 14 of the Wisconsin State Employes Collective Bargaining Agreement a laid off employe, upon written request at the time of layoff, may have his or her accumulated unused sick leave converted to cash at the current base pay rate for credits to be used to pay health insurance premiums during the time of the layoff. The employer will make the premium payments directly to the insurer. Premium payments will expire at the earlier of five years from the date of layoff or the first of the month following the employe's acceptance of any other employment. At the time of reinstatement or recall, unused cash credits will be reconverted to sick leave at the same rate for the original conversion and restored to the employe's sick leave account.

Are these payments of health insurance premiums considered taxable income to the employe for federal and state income tax purposes?

Answer: No, the employer's payment of health insurance premiums through conversion of accumulated sick leave under the WSEU Collective Bargaining Agreement is not taxable income.

In s. 71.02(2), 1983 Wis. Stats., Wisconsin adjusted gross income is defined as federal adjusted gross income, with certain prescribed modifications. Internal Revenue Code Section 61 provides that gross income means all income from whatever source derived, including compensation for services, unless specifically exempt. Gross income does not include the employer's contributions to accident or health plans for compensation (through insurance or otherwise) to employes for personal injuries or sickness, pursuant to Section 106 of the Internal Revenue Code.

Federal Revenue Ruling 75-539 discusses the tax treatment of medical insurance premiums paid for a retired employe in two situations. In the first situation, the employe has the option upon retirement to receive a cash payment for accumulated sick leave or to have the payment applied to the cost of health insurance. The amount of the cash payment which the employe is entitled to receive is considered taxable income at the time available to the employe, whether paid in cash or used to continue medical insurance coverage. In the second situation, the unused sick leave credits may be used to pay insurance premiums, but under no circumstances may the employe or the employe's spouse or dependents receive any of the amount in cash. Any amount not spent for health insurance premiums reverts to the employer. Such amounts are not considered constructively received by the employe, but are contributions by the employer to the health plan. These payments are excludable from taxable income.

Section 14 of the WSEU Collective Bargaining Agreement does not grant laid off employes the right to receive cash over which they have complete control. Because the employer makes premium payments directly to the insurer, the continuation of health insurance premiums is similar to the sick leave provision in the second situation discussed in Revenue Ruling 75-539. The cash value of the accumulated unused sick leave credits that are used by the employer to pay the health insurance premiums of the laid off employes qualifies as excludable income under Section 106 of the Internal Revenue Code.

3. Taxability of Railroad Retirement Benefits

Statutes: section 71.03(2), 1983 Wis. Stats.

Facts and Question: The enactment of the Social Security Amendments Act of 1983 (Public Law 98-21, April 20, 1983) made a portion of social security benefits subject to federal income taxes in certain situations. Section 231m of Title 45 of the United States Code was amended by Congress during 1983 to make some railroad retirement benefits equivalent to social security benefits and thus subject to federal tax. No provision in federal law prohibits state and local governments from taxing social security benefits.

Can Wisconsin impose an income tax on amounts of railroad retirement benefits which are taxable for federal income tax purposes in certain situations?

Answer: No, railroad retirement benefits are exempt from Wisconsin income tax. Section 231m of the United States Code continues to bar state and local taxation of railroad retirement benefits. On a 1984 Form 1, the Tier 1 railroad retirement benefits included in federal adjusted gross income are removed from Wisconsin taxable income when Columns B and C of line 14 are completed. Tier 2 or supplemental railroad retirement benefits included in federal adjusted gross income are subtracted from federal income on line 34 on a 1984 Form 1.

4. Treatment of Gain on Involuntarily Converted Property Replaced Outside Wisconsin

Statutes: sections 71.02(2)(b) and 71.05(1)(a)6, 1983 Wis. Stats.

Facts and Question: Section 1033 of the federal Internal Revenue Code (IRC) allows for postponement of recognition of gain on an involuntary conversion of property when replacement property is purchased within a specified period of time. Wisconsin, because of its reference to the definition of the IRC in s. 71.02(2), 1983 Wis. Stats., follows the provisions of the IRC unless an exception is noted.

Thus s. 71.02(2), 1983 Wis. Stats., allows the postponement of recognition of gain realized from the involuntary conversion of property by a Wisconsin resident, whether the replacement property is located within or outside of Wisconsin. Under s. 71.02(2), 1983 Wis. Stats., the deferral of gain on an involuntary conversion of property by a nonresident individual, estate or trust is also allowable when the replacement property is located in Wisconsin.

An exception to Section 1033 of the IRC is provided by s. 71.05(1)(a)6, 1983 Wis. Stats. Section 71.05(1)(a)6, 1983 Wis. Stats., provides an add modification by nonresident individuals, estates or trusts for the gain on the involuntary conversion of Wisconsin property excluded under Section

1033 of the IRC if the replacement property is located outside the State of Wisconsin.

Example: On June 30, 1983 a taxpayer received $10,000 for involuntarily converted property with a basis of $7,500. The taxpayer became a resident of Illinois on September 15, 1983 and purchased replacement property in Illinois on April 1, 1984 for $11,000.

Can the recognition of the $2,500 gain ($10,000 less $7,500 cost basis) from the involuntary conversion be postponed for Wisconsin income tax purposes?

Answer: Yes, recognition of gain on the involuntary conversion may be postponed for Wisconsin income tax purposes under s. 71.02(2), 1983 Wis. Stats. An add modification under s. 71.05(1)(a)6, 1983 Wis. Stats., is not required to include the gain in Wisconsin taxable income. The taxpayer's residency at the time the gain was realized is the controlling factor, not the taxpayer's residency at the time of replacement. As long as the taxpayer is a Wisconsin resident when the gain is realized, the gain on the involuntary conversion can be deferred as long as the taxpayer adheres to the provisions of Section 1033 of the IRC. (NOTE: If the taxpayer is a nonresident when the gain is realized, an add modification is required under s. 71.05(1)(a)6, 1983 Wis. Stats., to include the gain in Wisconsin taxable income.)

CORPORATION FRANCHISE/INCOME TAXES

1. Assessments by Wisconsin Public Service Commission

Statutes: section 71.04(2)(a), 1983 Wis. Stats.

Facts and Question: The Wisconsin Public Service Commission (PSC) is supported by all the public utilities, power districts and sewerage systems which it regulates. Under s. 196.85, 1983 Wis. Stats., the PSC bills these utilities directly for the cost of investigations, appraisals, and engineering or accounting services which it renders for them. At the end of each year the PSC assesses the public utilities, power districts and sewerage systems for the costs attributable to regulation but not directly related to any one utility. This assessment is called a remainder assessment and is based on the gross receipts of each utility.

Is the remainder assessment under s. 196.85(2), 1983 Wis. Stats., deductible on a Wisconsin franchise/income tax return of a regulated utility corporation?

Answer: Yes, the remainder assessment is deductible as an ordinary expense of doing business for a regulated utility corporation (s. 71.04(2)(a), 1983 Wis. Stats.). While the remainder assessment is based on gross receipts, it is not a tax; it is a fee imposed primarily to cover the cost and expense of regulation.

2. Nexus for Foreign Corporations Holding Wisconsin Partnership Interests

Statutes: sections 71.07(1m) and (2), 1983 Wis. Stats.

Wis. Adm. Code: sections Tax 2.39 and 2.82, September 1983 Register

Facts: Wis. Adm. Code section Tax 2.82 establishes certain activities of foreign corporations which constitute nexus for Wisconsin franchise/income purposes. Some of the more frequently encountered activities stated in the rule are maintenance of any business location in Wisconsin, including any kind of office, and ownership of real estate in Wisconsin.

Wis. Adm. Code section Tax 2.39 states that any person doing business both in and outside Wisconsin shall report by the statutory apportionment method when the person's business in this state is an integral part of a unitary business unless the department, in writing, allows reporting on a different basis.

Question 1: A general partnership has a sales office in Wisconsin. One of the partners is a corporation incorporated in a state outside Wisconsin. Does the partnership's sales office establish nexus with Wisconsin for the foreign corporation?

Answer 1: Yes. All partners, including the corporation, must file Wisconsin franchise/income tax returns and report their share of the partnership income.

Question 2: Foreign Corporation X is a member of a Wisconsin partnership with a sales office in Wisconsin which is an integral part of the corporation's unitary business. Can Corporation X use separate accounting to report its share of the Wisconsin net income from the operation of the Wisconsin partnership?

Answer 2: No. Because the Wisconsin partnership operation is a part of the corporation's unitary business operation, Corporation X must combine its share of the partnership income with the income from its regular business operations and use the statutory apportionment formula to determine Wisconsin net income.

3. "No Tax Change" Field Audits

Statutes: sections 71.09(13)(a), 71.10(10), 71.11(20) and (21)(a) and 71.12, 1983 Wis. Stats.

Background: The Wisconsin Board of Tax Appeals held in the case of *Superior Water, Light and Power Company* (1 WBTA 274) that a "no tax letter' is not considered an additional assessment under Chapter 71 of the Wisconsin Statutes. It also indicated in its *Amber, Inc.* (2 WBTA 571) decision that an adjustment to a net business loss is not an additional assessment in the year of the net business loss. As a result of these cases, a field audit (s. 71.11(20), 1983 Wis. Stats.) does not finalize the tax or income shown on the return or audit report if a no change letter is issued or if business losses are adjusted but no additional tax is assessed. Such years do not become final and conclusive as a result of a field audit. Rather, these years may be later adjusted by the taxpayer or the department within the statute of limitations, or a refund may be claimed for such no change years as long as it also is within the statute of limitations. A net business loss, for carryover purposes, may be adjusted for years beyond the statute of limitations as long as the income year against which it is used is open to adjustment.

Net Business Loss Offsets

Question 1: Is a notice sent to a taxpayer pursuant to a field audit indicating "no tax change" in one year and an adjustment to the net business loss of another year considered an additional assessment or correction of assess-

ment per s. 71.11(21)(a), 1983 Wis. Stats., for either of those years?

Answer 1: No. A "no tax letter" is not considered an additional assessment (*Superior Water, Light and Power Company*) and an adjustment to a net business loss is not an additional assessment in the year of the net business loss (*Amber, Inc.*).

Question 2: Are the "no tax change" for one year and the adjustment to the net business loss of another year appealable under s. 71.12, 1983 Wis. Stats., or any other statute?

Answer 2: No. A taxpayer may not seek the appeal remedies specified in s. 71.12, 1983 Wis. Stats., because the relief provided therein is available only to those who are aggrieved by an assessment, refund or notice of denial of refund. Such would not be the case here (this was cited by the Wisconsin Board of Tax Appeals in the *Superior Water, Light and Power Company* case).

Question 3: Is the income as reported in the "no tax change" year and the adjusted net business loss as shown on the audit report of another year considered to be final and conclusive under s. 71.12, 1983 Wis. Stats., or any other statute?

Answer 3: The Wisconsin Board of Tax Appeals ruled in the *Superior Water, Light and Power Company* case that the "no tax letter" is not provided for in the statutes nor does it operate with the same legal finality as does an additional assessment. Thus, the income reported in the "no tax change" year and the net business loss as determined by the department in the audit report may be adjusted at a later date by both the taxpayer and the department as indicated above.

Question 4: If both the taxpayer and the department may adjust the business loss as shown in the "no tax change" audit report, may adjustments be made to items shown in the audit report or only to items not included in the audit report?

Answer 4: Because there are no appeal remedies available to a taxpayer in a year that a net business loss is adjusted and because such a year does not become final and conclusive as a result of a field audit, adjustments may be made by both the taxpayer and the department to items shown in the audit report as well as to other items.

Question 5: If the department conducted a field audit of a taxpayer and the department made an assessment for one or more years audited but the final year of the audit was a loss year both before and after adjustments, may the department or the taxpayer further adjust the loss year in a subsequent year in which the loss is carried forward?

Answer 5: Yes. Under the principles set forth in *Amber, Inc.* (2 WBTA 571) a net business loss may be adjusted for a year beyond the statute of limitations as long as the income year against which it is used is open to adjustment.

Claim for Refund

Question 6: If the department conducted a field audit of a taxpayer and the department made no adjustment in one or more years audited, may the taxpayer file a claim for refund for the "no tax change" year(s) after the field audit has been concluded and department notification has been received?

Answer 6: Yes. In the *Superior Water, Light and Power Company* case, the Board of Tax Appeals ruled that a "no tax letter" sent by the department to the taxpayer at the conclusion of a field audit did not have the effect of barring the taxpayer's claim for refund of taxes within s. 71.10(10), 1983 Wis. Stats., since the letter was not a notice of an additional assessment within Chapter 71 of the Wisconsin Statutes.

Question 7: If the department conducted a field audit of a taxpayer for income or franchise taxes and made adjustments for all but the last year audited, may the taxpayer at some later date file a claim for refund (or the department make an assessment) for the last ("no tax change") year of the audit even though the field audit assessment has become final and conclusive?

Answer 7: Yes. If no timely petition for redetermination was filed, the years assessed would have become final and conclusive. However, the last year audited resulted in a "no tax change" and would not operate with the same legal finality as a year assessed (*Superior Water, Light and Power Company*).

Manufacturer's Sales Tax Credit

Question 8: Is a notice sent to a taxpayer pursuant to a franchise or income tax field audit indicating no change in tax in the years audited but reducing the manufacturer's sales tax credit carryforward to unaudited future years considered an additional assessment or correction of assessment under s. 71.11(21)(a), 1983 Wis. Stats.?

Answer 8: No. Pursuant to the *Superior Water, Light and Power Company* and *Amber, Inc.* cases, an "additional assessment" requires an assessment of tax liability greater than that reported.

Question 9: Is the reduction in the manufacturer's sales tax credit carryforward with no change in tax liability in the years field audited considered appealable under s. 71.12, 1983 Wis. Stats., or any other statute?

Answer 9: No. A taxpayer would have no reason to seek the appeal remedies specified in s. 71.12, 1983 Wis. Stats., because the relief provided therein is available only to those who are aggrieved by an assessment, refund or notice of denial of refund.

Question 10: Is the adjusted manufacturer's sales tax credit carryforward in Question 8 considered to be final and conclusive under s. 71.12, s. 71.10(10)(d), 1983 Wis. Stats., or any other statute?

Answer 10: No. In the *Superior Water, Light and Power Company* case, the Board of Tax Appeals ruled that "the no tax letter is not provided for nor does it operate with the same legal finality as does an additional assessment". Similarly, an adjustment to the manufacturer's sales tax credit carryforward, which is not considered an additional assessment, is not considered to be final and conclusive. The manufacturer's sales tax credit as determined by the department in the audit report may be adjusted at a later date within the statute of limitations by both the department and the taxpayer.

Farmland Preservation and Homestead Credits

Question 11: A notice is sent to a taxpayer pursuant to field audit indicating no change in the tax liability for a particular tax year but recovering a portion of the farmland preservation credit or homestead credit. (A) Is the income re-

ported in that tax year considered to be final and conclusive under s. 71.09(13)(a), s. 71.10(10)(d), 1983 Wis. Stats., or any other statute? (B) Is the farmland preservation credit or homestead credit as determined by the department considered to be final and conclusive if there was no timely appeal of the determination for the recovery of the farmland preservation credit or homestead credit?

Answer 11: (A) In accordance with the *Superior Water, Light and Power Company* case, there is no finality to the income because there was no "additional income or franchise tax assessment" under Chapter 71 of the statutes. (B) If no timely petition for redetermination of the farmland preservation credit or homestead credit is filed, the department's determination of the credit is final and conclusive under s. 71.90(13)(a), 1983 Wis. Stats.

4. Wisconsin Treatment of Foreign Sales Corporations and Domestic International Sales Corporations

Statutes: sections 71.04(4) and 71.11(7r), 1983 Wis. Stats.

Background: Under the Tax Reform Act of 1984 the system of Domestic International Sales Corporations (DISCs) will generally be replaced after December 31, 1984 with a new system of Foreign Sales Corporations (FSCs). Under the FSC system, a portion of the foreign trade income of an FSC will be exempt from federal tax at the corporate level, provided it is derived from the foreign presence and economic activity of the FSC. In contrast, under the DISC system there is no corporate income tax imposed on DISC income, and there is a partial deferral of taxes at the shareholder level. Although DISCs are not abolished by the Act, their tax benefits are limited and an interest charge for tax deferred amounts is imposed on DISC shareholders.

To qualify as an FSC, a corporation must meet six requirements designed to ensure that it has adequate foreign presence. If a corporation meets all six requirements, and makes an election that complies with the procedural requirements of section 927(f)(i) of the Internal Revenue Code, it will be treated as an FSC by the Internal Revenue Service. The six requirements are:

A. The FSC must be a foreign corporation created or organized under the laws of a qualified foreign country.

B. The FSC must not have more than 25 shareholders.

C. The FSC may not have any preferred stock.

D. The FSC must maintain an office located outside the United States (or in any U.S. possession) at which there is a permanent set of tax records, including invoices.

E. The board of directors of an FSC must always include at least one individual who is not a resident of the United States.

F. An FSC cannot be a member of any controlled group of corporations of which a DISC is a member.

In lieu of forming FSCs, taxpayers may continue to use their DISCs for annual export receipts up to $10 million. DISCs that continue in existence or are formed after 1984 will be known as "interest-charge" DISCs. As with other DISCs, their accumulated DISC income through 1984 will be exempt from federal tax. Most of the former DISC rules will continue to apply, including the gross receipts and assets tests. However, the former "incremental rule" will not apply, and the deemed distribution of DISC income is reduced from one-half to one-seventeenth.

Therefore, most DISC income after December 31, 1984 may be deferred for federal tax purposes although the shareholders of DISCs will be required to pay an interest charge on the deferred tax, the rate of which will be determined annually by the United States Treasury based on Treasury bill yields. The year-end of the FSC or an interest-charge DISC must conform to the year-end of its shareholder. If there is more than one shareholder, the year-end must conform to the year-end of the majority shareholder or the year-end of one of the shareholders owning equal highest percentage interests in the stock of the FSC or DISC.

This new federal legislation terminates the old DISC provisions as of December 31, 1984. A special transition rule treats distributions after January 1, 1985 as nontaxable amounts paid from previously taxed income of the DISC. Thus, the deferred tax liability is forgiven for federal income tax purposes.

Question 1: What is the Wisconsin treatment of FSCs?

Answer 1: Since the Wisconsin statutes contain no special provisions for FSCs, the net income of an FSC will not be subject to the combining provisions of s. 71.11(7r), 1983 Wis. Stats. The net income of an FSC is not to be combined with its parent or affiliate; it will be subject to Wisconsin taxation as a separate corporation provided it has nexus in Wisconsin.

Question 2: What is the Wisconsin treatment of interest-charge DISCs?

Answer 2: The net income of the newly created interest-charge DISC will also be subject to Wisconsin taxation as a separate corporation if the DISC has Wisconsin nexus. Since this type of DISC does not have the meaning specified in section 992 of the Internal Revenue Code, as amended to December 31, 1979, its net income also is not subject to the combining provisions of s. 71.11(7r), 1983 Wis. Stats.

Question 3: The Tax Reform Act of 1984 provides that as of December 31, 1984 the accumulated income of a DISC will be deemed previously taxed income and will be exempt from federal tax liability. Assume a corporation has a fiscal year ending October 31, 1985 and has a 100% owned DISC. Can this corporation deduct under s. 71.04(4)(b), 1983 Wis. Stats., 100% of any DISC dividends to be issued in January, 1985 or subsequently?

Answer 3: Yes, the corporation can under s. 71.04(4)(b), 1983 Wis. Stats., deduct 100% of any DISC dividends issued in January, 1985 or subsequently.

Since the Wisconsin statutes do not contain a provision similar to the federal provision which deems all accumulated DISC income to be previously taxed income exempt from tax after December 31, 1984, the distribution of such income will be taxed as dividends for Wisconsin corporation tax purposes, to the extent not excludable under s. 71.11(7r), 1983 Wis. Stats.

All dividends received from a DISC that are not excludable under s. 71.11(7r), 1983 Wis. Stats., may, however, be de-

ductible under s. 71.04(4), 1983 Wis. Stats., provided the requirements for deductibility are met (e.g., the corporation receiving the dividends must have owned directly or indirectly during the entire year at least 80% of the total combined voting stock of the payor corporation). For the taxable year 1984, 75% of the non-excludable dividends are deductible under s. 71.04(4)(b), 1983 Wis. Stats., while 100% of such dividends are deductible for 1985.

Question 4: Although most DISC shareholders are corporations, there are a few which have individual shareholders. Wisconsin law currently provides that 1984 taxable income of individuals is determined under the Internal Revenue Code as of December 31, 1983 and does not therefore include the 1984 federal law changes. Based on the fact that the normal year end of a DISC is beyond December 31, 1984 (e.g., January 31, 1985) but its year is deemed to end on December 31, 1984 under the provisions of the Tax Reform Act of 1984:

A. Will the deemed distribution that occurs on December 31, 1984 for federal tax purposes be included in net income in computing an individual shareholder's Wisconsin net income for 1984?

B. Will the answer to question 4A be different if the DISC ceases to exist as of December 31, 1984?

C. If the DISC changes its fiscal year to a calendar year for 1984 will this deemed distribution be taxable?

D. An individual shareholder having a fiscal year ending after December 31, 1984 and before July 1, 1985 will file a 1984 Wisconsin return. If the shareholder receives a distribution of accumulated DISC earnings between December 31, 1984 and June 30, 1985 will this distribution be taxed as a dividend? (For federal tax purposes this would be deemed to be a distribution of previously taxed income based on the amendments to the Internal Revenue Code in the Tax Reform Act of 1984.)

Answer 4A: No. The deemed distribution that occurs on December 31, 1984 for federal tax purposes will not be included in the 1984 net income of the shareholder for Wisconsin tax purposes unless the DISC has a normal year end of December 31, 1984.

Answer 4B: Yes. The deemed distribution that occurs on December 31, 1984 would be includable in the shareholder's 1984 Wisconsin net income if the DISC ceased to exist as of December 31, 1984 due to its liquidation.

Answer 4C: Yes. If a DISC changes its fiscal year to a December 31, 1984 calendar year, deemed distributions would be taxable because such distributions are considered by the Internal Revenue Code as being made on the last day of the tax year. The provisions of the 1983 Internal Revenue Code would have to be applied, however, in arriving at Wisconsin taxable income of individual shareholders.

Answer 4D: An individual shareholder having a fiscal year that ends after December 31, 1984 but no later than June 30, 1985 will file a 1984 Wisconsin return. If the shareholder receives a distribution of accumulated DISC earnings during the period January 1, 1985 through June 30, 1985, it would be taxable to the shareholder, to the extent this distribution has not previously been taxed, in accordance with the provisions of the 1983 Internal Revenue Code even though the 1984 Code would consider all of the accumulated earnings distributed as having previously been taxed.

SALES/USE TAXES

1. Blank Videotape Purchased by TV Station

Statutes: section 77.54(23m), 1983 Wis. Stats.

Facts and Question: A commercial television station uses blank or raw videotape in many ways in its day to day operations. Common uses of videotape are as follows:

A. Each time an employe goes out on a job to a news event the camera uses videotape to record what happened. Formerly film was used.

B. Commercials are made and recorded on tape.

C. A program on the network at one hour is videotaped and rebroadcast at another time.

D. Service announcements are prepared by the station on videotape.

E. Anything produced locally for TV broadcasting is recorded on videotape.

Section 77.54(23m), 1983 Wis. Stats., exempts "The gross receipts from the sale, lease or rental of or the storage, use or other consumption of motion picture film or tape,...." Does this exemption apply to raw and blank videotape purchased by a commercial television station as well as copyright video tape purchased by the station?

Answer: The sales/use tax exemption in s. 77.54(23m), 1983 Wis. Stats., applies to copyright videotape and raw or blank videotape purchased by a commercial television station.

2. Farmers' Irrigation Equipment

Statutes: section 77.54(3), 1983 Wis. Stats.

Facts and Question: Section 77.54(3), 1983 Wis. Stats., provides a sales/use tax exemption for tractors and machines, including accessories, attachments, fuel, and parts therefor, used directly in farming. A farmer may purchase all the component parts of an irrigation system, which would include pumps, power units to drive the pumps, above or below ground sectional piping, fittings and sprinkler devices; or a contractor may purchase the component parts of the irrigation system, install and sell the entire irrigation system to the farmer. The question is whether the entire irrigation system is real estate or personal property for sales tax purposes.

Answer: Section 70.04(2), 1983 Wis. Stats., provides that "the term 'personal property', as used in Chs. 70 to 79, shall include irrigation implements used by a farmer, including pumps, power units to drive the pumps, transmission units, sprinkler devices and sectional piping". Thus, the entire irrigation system, including the well and pumps, is considered personal property for sales tax purposes. Therefore, a farmer may purchase the component parts or the entire system without tax as an exempt farm machine under s. 77.54(3), 1983 Wis. Stats. A contractor may also purchase the component parts without tax "for resale" as personal property to the farmer.

3. Septic Tanks Owned by Municipality

Statutes: section 77.54(26), 1983 Wis. Stats.

Facts and Question: Section 77.54(26), 1983 Wis. Stats., provides a sales/use tax exemption for tangible personal property which becomes a component part of a waste treatment facility of any political subdivision of this state.

A village is constructing a new sewage treatment facility and collection system. This unique system consists of a septic tank and a submersible pump being located at each household in the village. When the liquid reaches a certain level in the septic tank the sewage is pumped to a final community septic tank where chlorine is added. As the sewage leaves the community septic tank it goes through a sand filter prior to its discharge into a nearby stream. Treatment of the sewage by bacterial action takes place in the septic tank at each household and also in the community facility.

Are a contractor's purchases of septic tanks, pumps and associated electrical equipment located at each household exempt under s. 77.54(26), 1983 Wis. Stats.?

Answer: The purchase of the septic tank is exempt because the village is treating its sewage at each household. However, purchases of the pumps and associated electrical equipment at each household are not exempt as they are part of the collection system used to move the sewage to the community septic tank.

4. Telephone Call Detail Charges

Statutes: section 77.52(2)(a)4, 1983 Wis. Stats.

Facts and Question: A person who is not in the business of providing long distance voice transmission service provides a customer with computer produced monthly reports showing how the customer's telephones are being used. The report can define the customer's telephone facility usage, call detail charges and provide various other accounting details. The customer has the option to choose from a variety of types of reports depending on the type of call detail it desires.

Are these call detail charges by a company which also sells and leases telephone equipment, but does not transmit messages for its customers, subject to the sales tax?

Answer: Yes. This computer provided service is a taxable telephone service under s. 77.52(2)(a)4, 1983 Wis. Stats., which imposes the tax on "the sale of telephone services of whatever nature. . . ."

5. Waste Reduction and Recycling Exemptions

Statutes: section 77.54(5)(c) and (26m), 1983 Wis. Stats.

Facts and Question: Section 77.54(5)(c) and (26m), 1983 Wis. Stats., provides sales/use tax exemptions for waste reduction or recycling machinery and equipment, effective July 1, 1984. The exemptions are for waste reduction or recycling machinery and equipment, including parts therefor, exclusively and directly used in waste reduction or recycling activities, which reduce the amount of solid waste generated, reuse solid waste, recycle solid waste, compost solid waste or recover energy from solid waste.

What is the scope of the exemptions provided by s. 77.54(5)(c) and (26m), 1983 Wis. Stats.?

Answer: In each factual situation described below presume that the purchaser is using the item exclusively and directly in the activity described.

A. Exempt Equipment

1. Equipment used in a foundry to clean sand so that the sand can be reused. Also, equipment used to remove impurities from lubricating oil used in manufacturing machines so that the oil can continue to be used by the manufacturer. These cleaning processes reduce the amount of solid waste produced.

2. Vending machines, located in parking lots, which collect aluminum cans and sort and crush the cans. The machines pay persons depositing the cans based on the weight of the cans deposited. The sorting for recycling constitutes a process beyond mere compacting.

3. Equipment used to produce fuel cubes. This equipment shreds waste paper and cardboard, removes foreign objects, blends the materials with a binding agent, adds moisture if necessary and then compresses the materials into fuel cubes, which are burned by homeowners or others to replace wood. This equipment recycles solid waste.

4. A roto-mill is a large piece of construction machinery which mines old pavement, whether it is asphalt or concrete, grinds up these mined materials, and then the materials recovered are reused in construction activities so that these recovered materials do not end up in a landfill.

B. Taxable Equipment

1. A can crusher used in a household.

2. Large steel waste collection containers (dumpsters) that are often found in back of business establishments. These large trash containers may be picked up and dumped into waste collection trucks, or hauled away on flat-bed trucks. They may also mechanically compact the waste in the container. They are used for the collection, storage and transportation of solid wastes, not in recycling or waste reduction.

3. A paper shredder in an office used to destroy confidential records.

4. A chain saw used to cut down diseased trees for firewood.

5. Shelving in a used-book store or any retail store that sells used goods.

6. Waste Reduction and Recycling Exemption for Road Machinery

Statutes: section 77.54(5)(c) and (26m), 1983 Wis. Stats.

Facts and Question: Section 77.54(5)(c) and (26m), 1983 Wis. Stats., provide sales/use tax exemptions for waste reduction or recycling machinery and equipment, effective July 1, 1984. The exemption is for waste reduction or recycling machinery and equipment, including parts therefor, exclusively and directly used in waste reduction or re-

cycling activities, which reduce the amount of solid waste generated, reuse solid waste, recycle solid waste, compost solid waste or recover energy from solid waste.

Certain road machinery mines highway asphalt or concrete in place and grinds it up. All the highway materials mined are reused in one way or another in future construction projects.

In the cold asphalt process, the mined asphalt is ground up, an emulsion is added, and the asphalt is relaid on the road surface. In the hot mix asphalt process, the mined asphalt must be trucked to a hot mix plant, which may be set up near the job site. At the mixing plant 40% recycled materials are mixed with 60% virgin materials to produce new hot mix. The percentages may vary but 100% of the mined materials are reused in constructing another highway, parking lot or other new construction.

Concrete also is mined and ground up for use in construction, but the mined concrete does not end up in the road surface; it is used as a base course to replace gravel and stone under a new concrete surface.

All of the mined materials recovered from highways by these road machines are used in future construction and thus do not end up in landfills. Are these machines exempt waste reduction and recycling machinery and equipment under s. 77.54(26m), 1983 Wis. Stats.?

Answer: The exemption in s. 77.54(26m), 1983 Wis. Stats., applies to these road machines if they are used exclusively and directly in reclaiming asphalt and concrete and reusing these recovered materials in constructing new highways, parking lots and other construction jobs. If a similar machine is used to repair a highway by profiling the highway, it would not be exempt under s. 77.54(26m), 1983 Wis. Stats., if the materials recovered are not reused.

HOMESTEAD CREDIT AND FARMLAND PRESERVATION CREDIT

1. Add Back for Gain on Sale of Principal Residence

Statutes: section 71.09(7)(a)1 and (11)(a)6, 1983 Wis. Stats.

Note: This Tax Release applies to calendar year 1983 and thereafter.

Facts and Question: For homestead credit and farmland preservation credit claims filed for 1983 and thereafter, the definition of household income in s. 71.09(7)(a)1 and s. 71.09(11)(a)6, 1983 Wis. Stats., includes the gain on the sale of a principal residence which was excluded from adjusted gross income under section 121 of the Internal Revenue Code. This section of the Code provides a one-time exclusion for the gain on the sale of a principal residence by an individual who is age 55 or older.

Gain on the sale of property which is disposed of in an installment sale must generally be reported under the installment method provided in section 453 of the Internal Revenue Code. However, a taxpayer may elect to report the entire gain in the year of sale. An installment sale is defined as a disposition of property where at least one payment is to be received after the end of the taxable year in which the sale occurs. Under the installment method, a portion of the gain is includable in income as payments are received.

If a homestead credit or farmland preservation credit claimant sold his or her principal residence on a land contract in 1983 or thereafter and elected to exclude all or part of the gain from taxable income under Internal Revenue Code section 121, what amount must be added back in computing household income?

Answer:

A. Entire Gain Excludable Under IRC Section 121

If the entire gain is excludable under Internal Revenue Code section 121, and the claimant qualifies to report the gain under the installment provisions of Internal Revenue Code section 453, the claimant may elect to add back the entire gain excluded in the year of sale, or the claimant may elect to add back a portion of the gain excluded each year as payments are received.

Example: On June 1, 1984, Claimant A sold his principal residence on a land contract for $75,000. The contract provided for a $15,000 down payment and principal payments of $15,000 on June 1, 1985, 1986, 1987 and 1988. Claimant A realized a $30,000 gain on the sale. The entire gain is excludable from adjusted gross income under Internal Revenue Code section 121 because Claimant A was age 55 at the time of sale. The sale meets the installment reporting requirements of Internal Revenue Code section 453.

Claimant A may elect to include the entire $30,000 gain in his 1984 household income for homestead credit or farmland preservation credit.

As an alternative, Claimant A may elect to include a portion of the gain in household income each year, computed under the rules for installment reporting. In 1984, the gain to be added back is $6,000 (($15,000 payment ÷ $75,000 contract price) × $30,000 gain excluded). In addition, $6,000 gain must be added back to household income for each of the years 1985, 1986, 1987 and 1988 on a homestead credit or farmland preservation credit claim filed for one of these years. Once the installment method of reporting is chosen, the claimant must continue to use this method on homestead credit or farmland preservation claims filed for 1985 and thereafter.

B. Part of Gain Includable in Federal Income

If part of the gain is includable in federal adjusted gross income as reported on the Wisconsin return, the claimant must use the same method for computing the add back for the homestead credit or farmland preservation credit claim as was used to compute Wisconsin adjusted gross income.

Example: On September 1, 1984, Claimant B sold her principal residence on a land contract for $250,000. The contract provided for a $50,000 down payment, with the $200,000 balance due September 1, 1987. Claimant B realized a $150,000 gain on the sale, of which $125,000 may be excluded under Internal Revenue Code section 121. The sale meets the installment reporting requirements of Internal Revenue Code section 453. For Wisconsin income tax purposes, Claimant B elected to report the $25,000 taxable gain ($150,000 − $125,000) on the installment basis.

On her homestead credit or farmland preservation credit claim, Claimant B must add back a portion of the excluded gain each year, computed under the rules for installment reporting. In 1984, the gain to be added back is $25,000

(($50,000 payment ÷ $250,000 contract price) × $125,000 gain excluded). Since no principal payments are to be received in 1985 or 1986, no add back is required for those years. In 1987, the gain to be added back is $100,000 (($200,000 payment ÷ $250,000 contract price) × $125,000 gain excluded).

C. Installment Reporting Requirements Not Met

If the claimant does not meet the requirements for installment reporting under Internal Revenue Code section 453, the claimant must add back the entire gain excluded on the homestead credit or farmland preservation credit claim filed for the year of the sale.

Example: On January 15, 1984, Claimant C sold his principal residence to his son on a land contract for $100,000. The contract provided for a $5,000 down payment, with the balance due over 30 years. Claimant C realized a $50,000 gain on the sale, which is excludable from adjusted gross income under Internal Revenue Code section 121. The sale does not meet the installment reporting requirements of Internal Revenue Code section 453 because Claimant C's son sold the residence to a third party on December 1, 1984.

Claimant C must include the entire $50,000 gain in his 1984 household income for homestead credit or farmland preservation credit.

2. Farmland Credit for Not-for-Profit Corporation

Statutes: section 71.09(11)(a) and (o), 1983 Wis. Stats.

Question: A not-for-profit corporation exempt from Wisconsin franchise and income taxes under s. 71.01(3), 1983 Wis. Stats., leases out farmland to a farmer and pays property tax on the land used for agricultural purposes. Is the not-for-profit corporation eligible for the farmland preservation credit?

Answer: Yes, if the not-for-profit corporation meets the eligibility requirements specified under s. 71.09(11)(a) and (o), 1983 Wis. Stats. For example, the following eligibility requirements must be met:

A. The corporation must have been the owner of the Wisconsin farmland for which the credit is being claimed during the income year for which the credit is claimed.

B. The corporation must have been organized under the laws of Wisconsin.

C. The farmland on which the claim is based must be at least 35 acres.

D. The farmland on which the claim is based must have produced at least $6,000 of gross farm profits, or at least a total of $18,000 in gross farm profits for the year of the credit and the two prior years combined. In the case of the above not-for-profit corporation, the lessee farmer's income from the farmland must meet the gross profits requirement.

E. The farmland must be subject to a certified zoning ordinance, or the corporation must have applied for a farmland preservation agreement by June 30 of the year for which the credit is claimed, and such agreement has been subsequently executed.

F. The household income of the corporation must be less than $36,622 for the income year for which the credit is claimed, as calculated on line 8 of Schedule FC. However, if the farmland is subject to an exclusive agricultural zoning ordinance, no limitation applies with respect to household income.

   Note that, as required for corporations subject to Wisconsin franchise or income taxes, the household income of a not-for-profit corporation must include the household income of each shareholder of the corporation (including the shareholder's spouse and minor dependents while members of the household) of record at the end of the corporation's year.

G. The corporation must not have been notified that it is in violation of a soil and water conservation plan.

Of the above eligibility requirements, the household income requirement may be the most difficult to determine. A not-for-profit corporation should compute its household income in the same manner as a corporation subject to Wisconsin franchise or income taxes. It should fill out Schedule FC by computing household income as if it had filed an income tax return and reported its gross income and deductions on the income tax return, and then carried the net amount over to Schedule FC.