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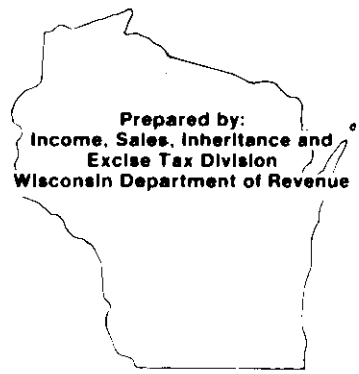

NEW TAX LAWS

The Governor's Revenue Bill and Budget Bill were still pending before the Wisconsin Legislature at the time this issue went to press. As soon as these bills become law, a special issue of the Wisconsin Tax Bulletin will be published to provide information about the tax law changes.

6-MONTH EXTENSION OF TIME TO FILE AVAILABLE TO CORPORATIONS

Federal law provides that corporations can receive from the IRS a 6-month extension of time to file their federal corporate income tax returns (federal Form 1120 series) by filing Form 7004, "Application for Automatic Extension of Time to File Corporate Income Tax Return."

Wisconsin law provides that any extension of time granted by the IRS for filing a federal return will also extend the time for filing the corresponding Wisconsin return (Section 71.10(5)(a), Wis. Stats.). Therefore, corporations allowed a 6-month extension by the IRS will also be allowed a 6-month extension to file their Wisconsin income/franchise tax return. A copy of the federal extension must be attached to the Wisconsin return when it is filed.

CONVICTION FOR SALES TAX EVASION

The former wife of former Posse Comitatus leader James P. Wickstrom was found guilty in Shawano County Circuit Court on tax evasion charges and was ordered to pay $4,170 in unpaid sales tax. She was also ordered to pay a fine and costs of $830.

Judge Thomas Grover found Mrs. Wickstrom guilty of six counts of selling merchandise without a state permit.

IN THIS ISSUE

VIOLATION OF STATE INCOME TAX LAW

A Fontana man has been ordered to serve two years probation and pay a $500 fine for criminal violation of the Wisconsin state income tax law.

James A. Begg, III, Fontana, was convicted in Walworth County Circuit Court, Branch 2, Elkhorn after he entered a no contest plea to one count of failing to file a state income tax return for 1985. Circuit Judge James L. Carlson withheld sentence, placed Begg on probation for two years and ordered him to pay a $500 fine as a condition of probation. Begg must also pay back taxes and interest in excess of $500 and file state income tax returns on time during the probationary period.

Criminal charges were filed against Begg by the Walworth County District Attorney's office after an investigation by the Intelligence Section of the Department of Revenue. Begg was charged with failing to file state income tax returns for each of the years 1983, 1984 and 1985. Charges for 1983 and 1984 were dismissed in accord with a plea agreement.

Wallace W. Radke, 713 - 21st Avenue, Monroe, Wisconsin was convicted in Green County Circuit Court, Monroe, after he entered no contest pleas to three counts of failing to file individual state income tax returns and one count of failing to file a corporation franchise tax return. Circuit Judge Franz W. Brand ordered Radke to pay a $400 fine on each of the first two counts, $300 on the third count, and $400 on the fourth count within 60 days. If the fines are not paid, Radke must serve 30 days in jail on each of the 4 counts, to be served consecutively.

Failure to file a Wisconsin state income tax return is a crime punishable by a fine of not more than $500 or imprisonment not to exceed 6 months or both for income tax returns due prior to July 20, 1985. Beginning July 20, 1985, the criminal penalty is a $10,000 fine or imprisonment not to exceed 9 months or both. In addition to the criminal penalties, Wisconsin law provides for substantial civil penalties on the civil tax liability.

EIGHT CHARGED FOR FILING FALSE MV-1'S

The following is taken from an article in the Milwaukee Sentinel dated April 14, 1987.

"The state Department of Revenue tax intelligence section is cracking down on car buyers for cheating on sales taxes paid in private purchases.

"Complaints against eight individuals who allegedly understated the purchase price of automobiles and trucks have been filed by the Dane County district attorney's office.

"The eight are scheduled for court appearances in May.

"The eight are charged with making false statements on a Motor Vehicles Division form on car purchases, according to Assistant District Attorney Douglas L. McClean.

"By underreporting the purchase price, the sales tax liability was reduced, he said.

"According to separate complaints:

"Curtis R. Greaves, of DePere, paid $150 tax on the purchase of a 1984 Ford Bronco for $3,000. Tax investigators believe the price was $10,000, with tax owed of $500.

"Peter A. Stark, of Oconto, bought a 1984 Pontiac Fiero, allegedly for $7,000, but reported at $1,600, with a tax of $80, instead of $350.

"Eugene A. Brossard, of Racine, bought a 1984 Ford truck for $8,300, but reported it at $3,000, paying $150 in tax, instead of $415.

"William T. Lee, of Burlington, bought a 1983 Chevrolet Z-28 for $7,000, but reported it at $2,000, with tax liability of $100, instead of $350.

"Craig A. Lapp, of Kenosha, bought a 1983 Oldsmobile for $10,000, but reported it at $4,000. The tax reported was $200, instead of $500.

"Dwayne A. Braun, of Beaver Dam, bought a 1984 GMC vehicle for $9,500, but reported at $5,000, carrying a sales tax of $250 when it should have been $425.

"Richard Lorentsen, of Racine, bought a 1983 Datsun truck for $5,800, but reported at $1,400 with a sales tax of $70, while it should have been $290.

"Kevin R. Krautkramer, of Mosinee, was also named, but details of that transaction were not available."

A purchaser of a motor vehicle must file a sales tax report (Form MV-1) prior to registering or titling the motor vehicle in Wisconsin if the motor vehicle was purchased from someone who is not a motor vehicle dealer.

NEW ISI&E DIVISION RULES AND RULE AMENDMENTS IN PROCESS

Listed below, under Parts A and B, are proposed new administrative rules and amendments to existing rules that are currently in the rule adoption process. The rules are shown at their state in the process as of June 15, 1987. Part C lists new rules and amendments which are adopted. ("A" means amendment, "NR" means new rule, "R" means repealed and "R&R" means repealed and recreated.)

A. Rules at Legislative Council Rules Clearinghouse

2.16 Change in method of accounting for corporations-A
2.19 Installment method of accounting for corporations-A
2.20 Accounting for acceptance corporations, dealers in commercial paper, mortgage discount companies and small loan companies-A
2.21 Accounting for incorporated contractors-A
2.22 Accounting for incorporated dealers in securities-R&R
2.24 Accounting for incorporated retail merchants-A
2.25 Corporation accounting generally-A
2.26 "Last in, first out" method of inventorying for corporations-A
2.395 Sales factor option-NR
2.45 Apportionment in special cases-A
2.50 Apportionment of net business income of interstate public utilities-A
2.505 Apportionment of net business income of interstate professional sports clubs-A
2.53 Stock dividends and stock rights received by corporations-A
2.56 Insurance proceeds received by corporations-A
2.65 Interest received by corporations-A
2.72 Exchanges of property by corporations generally-A
2.721 Exchanges of property held for productive use or investment by corporations-A
2.83 Requirements for written elections as to recognition of gain in certain corporation liquidations-A
2.88 Interest rates-A
3.44 Organization and financing expenses—corporations-R&R
3.45 Bond premium, discount and expense—corporations-A

B. Rules at Legislative Standing Committees

11.10 Occasional sales-A

C. Rules Adopted in 1987 (effective 8/1/87)

1.06 Application of federal income tax regulations for persons other than corporations-A
1.10 Depository bank requirements for withholding, motor fuel, general aviation fuel and special fuel tax deposit reports-A
1.13 Power of attorney-A
2.01 Residence-A
2.03 Corporation returns-A
2.05 Information returns, forms 8 for corporations-A
2.08 Returns of persons other than corporations-A
3.07 Bonuses and retroactive wage adjustments paid by corporations-A
11.05 Governmental units-A
11.08 Medical appliances, prosthetic devices and aids-A
11.09 Medicines-A
11.10 Occasional sales-A
11.12 Farming, agriculture, horticulture and floriculture-A

11.14 Exemption certificates (including resale certificates)-A
11.16 Common or contract carriers-A
11.27 Warranties-A
11.28 Gifts, advertising specialities, coupons, premiums and trading stamps-A
11.39 Manufacturing-A
11.41 Exemption of property consumed or destroyed in manufacturing-A
11.45 Sales by pharmacies and drug stores-A
11.49 Service stations and fuel oil dealers-A
11.65 Admissions-A
11.66 Communication and CATV services-A
11.80 Sales of ice-A
11.84 Aircraft-A
11.85 Boats, vessels and barges-A
11.88 Mobile homes-A
11.94 Wisconsin sales and taxable transportation charges-A
11.96 Interest rates-A

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

Erwin D. Russell (p. 3)
Sale of residence

Annette L. Turner (p. 4)
Taxation of Indians

Corporation Franchise/Income Taxes

Avon Products, Inc. (p. 4)
Petition for review

ITT Life Insurance Corporation (p. 4)
Privileged documents

Kohler Company, Kohler Company—Successor to Kohler International Ltd., Kohlerco DISC, Inc. and KIL DISC, Inc. (p. 4)
Domestic International Sales Corporation

Project Systems, Inc. (p. 5)
Apportionment—nexus

Savings League of Wisconsin, Ltd., Equitable Savings & Loan Association, Liberty Savings & Loan Association, and Marathon County Savings & Loan Association (p. 6)
Dividends and interest—taxable

Sales/Use Taxes

Artex Corporation (p. 6)
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Water conditioners

Homestead Credit

Myrtle Berglin (p. 9)
Property taxes accrued—joint ownership

INDIVIDUAL INCOME TAXES

Sale of Residence. *Erwin D. Russell vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, January 30, 1987). The issue pending before the Tax Appeals Commission is whether the taxpayer is required to report 100% of the gain realized from the sale of the real estate located at 8725 North Greenvale Road, in Bayside, Wisconsin.

Erwin D. Russell filed with the department his 1981 Wisconsin resident individual income tax return and reported on Schedule D $30,381 as proceeds received from the sale of real estate located at 8725 North Greenvale Road in the Village of Bayside.

The taxpayer and Flo Ann Russell, a/k/a Flo Ann O'Rourke, were divorced in Milwaukee County on November 10, 1970, and their judgment of divorce was dated November 30, 1970. Flo Ann Russell occupied the house located at 8725 North Greenvale Road until approximately January 20, 1981. On January 20, 1981, the property was sold to Richard W. and Margaret A. Render. Flo Ann O'Rourke, f/n/a Flo Ann Russell, and her then husband, Leslie E. O'Rourke, executed on January 18, 1981 a quit claim deed to the property. In the quit claim deed, the property was represented to be homestead property. The quit claim deed was duly recorded in the Milwaukee County Register of Deeds office on January 22, 1981.

The total amount of net proceeds from the sale of the real estate located at 8725 North Greenvale Road was $84,532.65. A check for the net proceeds was issued jointly to the taxpayer and Flo Ann Russell, dated January 21, 1985.

Flo Ann Russell received $54,944.90 of the total amount of the proceeds from the sale of the real estate in question, which represents 75% of the gain realized less an adjustment of $8,454.59 which was made in order to reimburse the taxpayer for various expenses he incurred during the period from December 1, 1970 to January 20, 1981. The expenses were for payments of principal on the mortgage, sewer assessments, water assessments, and repairs and improvements to the property. The taxpayer received $29,587.75 of the net proceeds from the sale of the real estate, which represents 25% of the gain realized from the sale plus an adjustment of $8,454.59 which was made in order to reimburse the taxpayer for various expenses he incurred during the period from December 1, 1970 to January 20, 1981.

The Commission concluded that income realized on the sale of real estate in Wisconsin is properly assessable to the record title holder of the property. The taxpayer realized 100% of the capital gain on the 1981 sale of the real property and the department acted properly in assessing an income tax on 100% of the gain realized on the sale of the property.

The taxpayer has not appealed this decision.

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Taxation of Indians. *Wisconsin Department of Revenue vs. Annette L. Turner* (Circuit Court of Dane County, January 21, 1987). This matter is on an appeal from an order of the Wisconsin Tax Appeals Commission in which it determined that the State of Wisconsin does not have jurisdiction or authority to tax an enrolled member of the Oneida Tribe and a domiciliary of the Oneida Indian Reservation for income earned on active duty in the United States Army while stationed in Kansas.

Sergeant Annette L. Turner, an enrolled member of the Oneida Indian Tribe and a domiciliary of the Oneida Indian Reservation in Wisconsin, claims a refund for taxes paid to Wisconsin on income earned while on active duty with the United States Army stationed outside the State of Wisconsin and outside the Oneida Indian Reservation. Her only source of income was from this service.

The Circuit Court concluded that based on state and federal law, and the special protections accorded Indians, Sergeant Turner's military income, earned while she is stationed in Kansas, is protected from Wisconsin income taxation. Accordingly, it found the Wisconsin Tax Appeals Commission's application of the law to be reasonable, and not arbitrary or capricious, and affirmed their order.

The department has not appealed this decision.

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CORPORATION FRANCHISE/INCOME TAXES

Petition for review. *Avon Products, Inc. vs. Wisconsin Department of Revenue* (Circuit Court of Dane County, August 21, 1986). The Department of Revenue moved the Court to dismiss Avon Products, Inc.'s action for lack of subject matter jurisdiction. The department asserted that Avon Products, Inc., failed to comply with the statutory requirements for service, resulting in a lack of subject matter jurisdiction.

The resolution of the motion to dismiss depends upon the Court's interpretation of s. 227.16, Stats., dealing with proceedings for review of administrative decisions. More specifically, the Court must determine which agency must be served with the petition for review personally or by certified mail. Here, Avon served the Commission with the petition by regular mail, while serving the department personally or by certified mail. The situation is complicated by the fact that the Commission did not actually receive the petition for review within the thirty day time limit for review set by s. 227.16. Two questions must be answered in order to resolve this motion:

A. Does s. 227.16(1)(a), Wis. Stats., require that Avon Products, Inc., serve the Wisconsin Tax Appeals Commission within thirty days of its final decision via personal service or certified mail?

B. If Avon Products, Inc., was required to serve the Commission within thirty days of the final decision via personal service or certified mail, was its failure to do so reasonable because of ambiguous statutory language?

The Circuit Court concluded that s. 227.16(1)(a), Wis. Stats., directs that the Wisconsin Tax Appeals Commission must be served personally or by certified mail with a petition for review within the thirty day time limit. Avon Products, Inc.'s failure to comply with this requirement was unreasonable as the statutory language was not ambiguous. Therefore, because the Court lacked subject matter jurisdiction, the department's motion to dismiss was granted. Because the Court determined that Avon Products, Inc., failed to meet the service requirement which must be strictly adhered to, there was no reason to reach the issue of timeliness of the service via regular mail attempted by Avon Products, Inc.

The taxpayer has not appealed this decision.

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Privileged documents. *Wisconsin Department of Revenue vs. Wisconsin Tax Appeals Commission and ITT Life Insurance Corporation* (Circuit Court of Dane County, October 15, 1986). The initial question for resolution is whether a writ of prohibition is an appropriate remedy in this factual situation. Secondly, the Court must determine whether the documents in question are, in fact, privileged under either the attorney-client communications theory or the work product theory.

The Department of Revenue sought a writ of prohibition restraining the Wisconsin Tax Appeals Commission from enforcing its recent decision ordering the Department of Revenue to produce certain documents sought by ITT Life Insurance Corporation. The Department of Revenue contends that the documents in question are privileged documents falling into a protected status under the attorney-client privilege and the attorney work product privilege.

In order to support issuance of the writ, the department must show that the ordinary remedies, such as appeal, are inadequate. The department must also show that grave or extraordinary hardship will result if the writ does not issue.

The Circuit Court concluded that all of the documents in question fall within the attorney-client communications privilege and, thus, are protected from discovery by the opposing party. It is beyond the scope of the Commission's authority to order that the materials be released to ITT.

The Wisconsin Tax Appeals Commission ignored a clear duty to protect the documents in question from discovery by ITT. Because compliance with the Commission's order followed by an appeal carries with it inherent harm, the Court found such a remedy to be inadequate, causing irreparable harm to the department. For these reasons, the Writ of Prohibition **shall** issue. The Wisconsin Tax Appeals Commission is prohibited from enforcing its order dated September 5, 1986, with regard to the documents enumerated.

The taxpayer has not appealed this decision.

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Domestic International Sales Corporations. *Wisconsin Department of Revenue vs. Kohler Company, Kohler Company - Successor to Kohler International, Ltd., Kohlerco DISC, Inc. and KIL DISC, Inc.* (Circuit Court of Sheboygan County, January 20, 1987). This is a review brought on the petition of the Wisconsin Department of Revenue for review of the

Wisconsin Tax Appeals Commission's decision and order dated November 22, 1985. The decision and order modified the department's actions on the taxpayer's petitions for redetermination of franchise taxes due from the taxpayers.

Kohlerco DISC, Inc. and KIL DISC, Inc., were organized in 1974 as wholly-owned subsidiaries of Kohler Company and Kohler International, Ltd., respectively. In 1977 Kohler International merged into the Kohler Company, and both DISC's therefore became wholly-owned subsidiaries of the Kohler Company. All of the taxpayers are Wisconsin corporations with headquarters at Kohler, Wisconsin.

Kohlerco DISC, Inc. and KIL DISC, Inc. were typical commission agent DISC's having no employees, no tangible property, and only the minimal corporate substance and transactions necessary for Kohler Co. and KIL to obtain the DISC benefit of federal tax deferral. The DISC's were incorporated in Wisconsin but had minimal corporate activity consisting of annual unanimous consents electing their officers and directors, who were the same as the principal officers of Kohler Co. and KIL, and an annual unanimous consent declaring a dividend to the parent company. The DISC's had separate books and records which were maintained by employees of Kohler Co.'s corporate accounting department. These consisted of journals and ledgers reflecting commissions paid by the parents to the DISC's and the immediate return of the monies to the parent companies, generally by simultaneous exchange of checks, either as payment of dividends to the parents or for the purchase of parent account receivables from the DISC export sales. The latter device permitted the DISC's to satisfy the requirement that at least 95% of their assets be held in qualified export assets. The DISC's had separate bank accounts but because all payments to the DISC's were immediately returned to the parents, they never had more than nominal balances of $192 and $211, respectively, except momentarily for the time it took the checks that were exchanged to clear.

The state Appellate Courts which have considered taxation of the earnings of DISC's have all found that states can tax the same. However, the cases are split as to whether the tax is to be allocated to the DISC or the parent corporation. The cases have held that state laws permitting such taxation are constitutional, do not discriminate against interstate and foreign commerce, and are not in violation of the Supremacy Clause of the U.S. Constitution.

The department relies on s. 71.11(7m), Wis. Stats., which provides in part that the Department of Revenue "...may... allocate gross income...if (it) determines that such...allocation is necessary..."

On the undisputed facts the Tax Appeals Commission reached the following conclusion: "Income is taxable to the one who earns it, and therefore, the income of the DISC's should be allocated to the parent corporations, Kohler Co. and KIL for purposes of determining Wisconsin franchise taxes on said income, in order to clearly reflect the income of these corporations."

The Circuit Court affirmed the Wisconsin Tax Appeals Commission's decision.

The department has not appealed this decision.

□

Apportionment—nexus. *Project Systems, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, February 13, 1987). The issue before the Commission is whether, during 1974 through 1979, the taxpayer was entitled to apportion its income for Wisconsin franchise tax purposes between Wisconsin and Michigan under s. 71.07(2), Stats., and related administrative rules.

The taxpayer is a wholly-owned subsidiary of Allis-Chalmers Corporation and is part of the unitary business of Allis-Chalmers Corporation. The taxpayer is a member of the Allis-Chalmers combined group in Kentucky, California, Oregon, North Dakota, and Idaho for state income/franchise tax purposes. It pays a minimum tax in Minnesota. For the years 1977 through 1979, the taxpayer paid taxes to Michigan based on apportionment factors of 90.17%, 89.43% and 94.86%, respectively.

The taxpayer is a professional service corporation. Its principal business activity is providing professional engineering services (e.g., detail design of a building, foundation design, "civil" engineering).

The taxpayer has no real or tangible personal property. In lieu of payroll, the taxpayer pays management and service fees to Allis-Chalmers Corporation for the personal services of Allis-Chalmers Corporation's employes, for performing the taxpayer's managerial and engineering services. The taxpayer had no payroll, and had no employes other than its corporate officers who were employes of Allis-Chalmers Corporation and on the payroll of Allis-Chalmers Corporation. In carrying out the contracts, the Allis-Chalmers employes were responsible to and under the direct supervision and control of the taxpayer. In carrying out the contracts, Allis-Chalmers employes held themselves out to customers as the taxpayer's employes. The taxpayer's customers believed that Allis-Chalmers employes were employes of the taxpayer.

The management and services fees the taxpayer pays to Allis-Chalmers Corporation are for services performed by Allis-Chalmers Corporation personnel in Wisconsin and at the various job sites in Michigan, Minnesota, and Texas. Over the period 1974 through 1979, aggregate fees were approximately 20% for management and 80% for engineering. Management services are performed nearly all in Wisconsin. Eighty percent of the engineering services were performed in West Allis with the remaining 20% of the engineering services performed on job sites outside of Wisconsin.

The taxpayer reported an apportionment percentage to no state other than Wisconsin except on its Michigan 1977 through 1979 returns. The Michigan percentage consists of a gross receipts factor.

In disallowing the apportionment, the department Audit Bureau explained as follows:

Disallow Apportionment

"In accordance with Wisconsin Administrative Code Tax 2.39 t/p [taxpayer] has no provisions for using the apportionment method for Wi Franchise Tax purposes. T/P has no property, payroll or cost of performance in rendering its engineering services. Consequently, all income realized

cannot be apportioned and must be reported to Wi, a state where t/p maintains its commercial domicile."

In its petition for redetermination the taxpayer gave the following reason in respect to the apportionment issue:

"The disallowance of apportionment was in error because Wis. Adm. Code Tax 2.39(2) allows this corporation to apportion income. It has income from business activity subject to taxation in other states. It performs a portion of its engineering services in the state in which the respective project is located. Tax 2.39(4) defines compensation to include fees paid to a selected corporation as consideration for the performance of personal services. This taxpayer utilized the personal services of Allis-Chalmers employees for a fee to render engineering services in the State of Michigan. Taxpayer also purchased and resold goods in the ordinary course of its business which were destined outside the State of Wisconsin. These should be apportioned under Tax 2.39(5)."

In denying the petition for redetermination, the department stated as follows:

"It is the Department's position that the corporation does not have nexus in any other state and therefore is not entitled to use the apportionment method of reporting."

The Commission concluded:

A. During the years 1974 through 1979, the taxpayer had "nexus" with the State of Michigan, within the meaning of s. Tax 2.82(1)(a), Wis. Adm. Code.

B. During the years 1974 through 1979, the taxpayer was "engaged in business within and without the state" within the meaning of s. 71.07(2), Stats., and "subject to taxation by this state and at least one other state," within the meaning of s. Tax 2.39(2), Wis. Adm. Code. Accordingly, the taxpayer was entitled to use the apportionment method in determining its income for Wisconsin franchise tax purposes if it had proper sales, payroll or property factors upon which it could do so.

C. During the years 1974 through 1979, the taxpayer had no property upon which an apportionment property factor could be determined. The taxpayer's payment of management or service fees to Allis-Chalmers was "compensation" for purposes of the "payroll factor" under s. 71.07(2)(b), Stats., and s. Tax 2.39(4), Wis. Adm. Code. However, the situs of such compensation was Wisconsin under s. 71.07(2)(b)4, Stats.

D. For the years 1974 through 1979, the "sales factor" for apportionment purposes is determinable under s. 71.07 (2)(c)3, Stats., and s. Tax 2.39(5)(f)5. b.(iii), Wis. Adm. Code. Under the administrative provision compensation has a Wisconsin situs under s. 71.07(2) (b)4, Stats., if the other state lacks jurisdiction to tax. Such is not the case here. The taxpayer's gross receipts for sales factor purposes under s. Tax 2.39 (5)(f)5.b.(iii), Wis. Adm. Code, are apportionable between Michigan and Wisconsin in the ratio of the Wisconsin compensation to total compensation, that is, Wisconsin plus Michigan. There is no evidence of record as to what those respective costs were.

The department's redetermination that the taxpayer had no nexus in Michigan during 1974 through 1979 is reversed. The taxpayer's income is apportionable.

The department has not appealed this decision.

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Dividends and interest—taxable. *Savings League of Wisconsin, Ltd., Equitable Savings & Loan Association, Liberty Savings & Loan Association and Marathon County Savings & Loan Association vs. Wisconsin Department of Revenue* (Circuit Court of Dane County, August 20, 1986). The sole issue raised is whether the corporate franchise tax imposed by s. 71.03(1)(c) and (d), Wis. Stats., violates 31 U.S.C. 742 and Art. VI (supremacy clause) and Art. I Section 8, C1. 2 (borrowing clause) of the U.S. Constitution, because it is really an income tax that invalidly includes interest and dividends on U.S. government obligations as net income for tax purposes.

The Wisconsin franchise law requires earning of the income in the previous year and the exercise of the privilege of doing business in the state in the current year before a corporate franchise tax is imposed.

The Court concluded that Wisconsin's franchise tax is not an income tax, and that the inclusion of interest and dividends on U.S. government obligations does not violate either the supremacy or the borrowing clause of the U.S. Constitution. Therefore, the Court granted summary judgment for the department and declared s. 71.03(1)(c) and (d), Wis. Stats., valid.

The taxpayers have appealed this decision to the Court of Appeals.

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SALES/USE TAXES

Construction contractors—grain bins. *Wisconsin Department of Revenue vs. Artex Corporation* (Court of Appeals, District IV, January 26, 1987). The department appeals from an order of the Circuit Court affirming the Wisconsin Tax Appeals Commission's determination that because the grain bins Artex Corporation (Artex) constructed are manufacturing property within the meaning of s. 77.54(6)(a), Stats., Artex was therefore entitled to a use tax exemption under that statute. See WTB 44 for a summary of the Circuit Court decision.

Artex is in the business of constructing feed processing plants and grain elevators. Between December 1979 and November 1981, Artex installed some machinery and equipment at the Dane County Farmers Union Cooperative (Cooperative) to expand its corn processing facility. The machinery and equipment consisted of an aeration tank and system which, for the purpose of this appeal, shall be referred to as the grain bins.

In 1982, the department issued a use tax assessment against Artex for the amount of $24,939.33, including interest, on the materials Artex purchased and used to construct the grain bins. Because these materials were from out-of-state manufacturers, Artex had paid no Wisconsin sales or use taxes on its purchases of these materials.

Artex contends, and the Commission and trial court agreed, that it is exempt from paying use taxes in this case because the property which is the subject of the as-

sessment constitutes machines and specific processing equipment used exclusively and directly by a manufacturer, the Cooperative, in manufacturing tangible personal property (s. 77.54(6)(a), Stats.).

The Court of Appeals concluded that under s. 77.54(6)(a), Stats., Artex is not exempt from paying a use tax on the materials used in the construction of the grain bins, and reversed the decision of the trial court. Artex' argument overlooks two important facts:

A. Artex was assessed a use tax on materials purchased from out-of-state firms to construct the grain bin and not a sales tax on the sale of a piece of machinery used in the manufacturing process.

B. Artex is merely the contractor who constructed the bin, and not the manufacturer who is using the bin in its manufacturing process.

The taxpayer has appealed this decision to the Supreme Court.

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Computer and data processing— programs. *International Business Machines Corporation vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, March 23, 1987). The principal issues as presented for decision are the following:

A. Taxability for Wisconsin sales tax purposes of the taxpayer's licensing of what it now calls "feature" computer programs to Wisconsin customers during the period in question;

B. If not taxable in whole or in part, the proper amount of refund to which the taxpayer is entitled; and

C. Whether the taxpayer's amendment of the claims for refund before this Commission was permitted for the period covered by field audit.

The taxpayer was at all relevant times a corporation organized and existing under the laws of the State of New York with its corporate headquarters at Old Orchard Road in the Village of Armonk, Westchester County, New York State. Among other items, the taxpayer is engaged in the manufacture of computer programs. It manufactures two general classes of programs: standard programs (also called "build to plan") and non-standard programs (also called "build to order"). No standard programs are involved in this case. There are two kinds of non-standard programs: "custom programs" and "feature programs". There are no "custom programs," as IBM uses that term, involved in this case.

Feature programs are manufactured by the taxpayer to customer requirements specific to a unique customer and a unique customer's computer. Feature programs are made one at a time to the special order of the customer. A feature program as finally built for the customer does not exist as such before the customer orders it. The taxpayer does not sell feature programs, but rather grants the customer a "license" to use them, for which it charges a fee. The terms of the license are stated in a standard form of written agreement between the taxpayer and the customer.

IBM grants the customer a non-transferrable and non-exclusive license to use the programs on the customer's computer designated in a written supplement to the agreement. The charges applicable to each program consist of monthly charges (or a one-time charge in lieu thereof) and any initial charge and/or process charge. Most commonly, the customer pays a monthly license charge. Depending on the program, there may also be an initial license charge, typically three to four times the monthly license charge. Other forms of charges are a "paid-up" license, where if the customer makes a certain number of monthly payments, the customer continues to use the program without making additional payments, and a "one-time" charge, where a customer for one initial payment can continue to use the program as long as desired. IBM provides the same services to licensees of feature programs no matter what pricing mechanism is used. The pricing mechanism selected is typically a matter of economics so that IBM does not wind up billing very small amounts to customers. The charges depend on the nature of the program and the time the customer has the right to use the program, not the physical attributes of the magnetic tape or diskette or the time the customer has physical possession of the magnetic tape or diskette.

The customer agrees to pay amounts equal to any taxes, other than property and income taxes. IBM has stated that if it successfully obtains a refund in this case, it will be passed on to its customers. IBM has not stated what it intends to do with what would amount to substantial interest due on any refund.

The licensing agreement states that IBM "will notify the Customer of the type of program storage media required for shipment," and that "unless returnable or disposable media are used, the program storage media must be provided by the Customer or ordered from IBM at the applicable charge." The diskettes and tapes IBM ordinarily uses to transmit programs are returnable media.

IBM does not charge the customer for tapes or diskettes used to transmit the feature program and agrees to replace the program and program storage media without charge if they are lost or damaged during the shipment from IBM. If they are lost or damaged while in the customer's possession, IBM agrees to replace them "at the applicable charges, if any, for processing, distribution and/or program storage media." If the customer receives the program and loses the storage media before the program is installed, there is no additional charge for replacing the program and the media.

The feature program is IBM's property, and is never sold to the customer outright. It is copyrighted in IBM's name, and IBM never sells or transfers the copyright. Notice of copyright is not filed on each feature program, but rather on each program module which constitutes a prewritten segment of a program.

A copy of the program is transmitted to the customer, typically using magnetic tape or diskettes, but telephone, microwave and satellite transmission can be used. The program is installed and tested, usually being changed to take into account the customer's environment. The customer is given documentation, training and testing so the program can be used effectively and efficiently. At the end of the installation and test period, there may be significant differences between the program as originally received by the customer and the program as it then exists. The customer is provided updating and maintenance services to keep the program up to date and resolve problems.

If the taxpayer separately priced the maintenance and updating services provided with the licensing of a feature program, the value of these services would account for approximately 35% of the license fee.

Tangible personal property in the form of magnetic tapes and diskettes was transferred by the taxpayer to its customers as part of its licensing of feature programs. The cost of blank tapes and diskettes which are subsequently used as the medium for copies of the feature programs is minimal in comparison to the license charge. However, the customer did not receive or license blank tape or diskettes, but rather tapes or diskettes enhanced with coded programming information.

When a customer obtains a feature program, what the customer receives is the coded information included in the program, in machine readable form, plus the documentation and installation instructions included in the program or provided separately, all of which allow the computer to perform a certain function such as doing a payroll. That is the object of the transaction of ordering the feature program — to obtain a machine readable copy of a program designed for use in a certain computer environment. The coded information included in the program is in the form of electronic or magnetic impulses, but could have been in the form of punch cards, compact disk, laser disk of some other form capable of retaining information in binary machine language readable by the computer regardless of whether the information is data or instructions. There are various ways other than physical possession of a tape or diskette to make a program accessible to a computer, including transmission over a telephone line.

The Commission concluded:

A. The taxpayer's gross receipts from the licensing of feature programs were not derived from the transfer of tangible personal property, described in s. 77.51 (4)(h), Wis. Stats., or the furnishing of services described in s. 77.52(2)(a)11, Wis. Stats., and are therefore not taxable under the provisions of s. 77.52, Wis. Stats.

B. The burden of proving the department's determination of a refund due to be incorrect is generally on the taxpayer. However, the department did not make an administrative determination as to the correct amount of sales tax refund pertaining to the program licenses in question in the proceedings before it, has been unable or prevented from obtaining information to enable it to do so from the taxpayer, and has not conceded the correctness of the amount of the taxpayer's claim. Therefore, the Commission lacks any power of review of the amount at this time.

C. Since the additional amount claimed by the taxpayer is based upon a recomputation of the claim originally submitted, rather than on a new claim for refund of a different type of transaction from that covered by the original claim, the field audit assessment is not, under s. 77.59(4), Wis. Stats., a bar to such amendment since it did exempt from finality the original claim for refund.

D. This decision is rendered by this Commission in accordance with s. 73.01 (4)(e), Stats. Therefore, that department's determination that the taxpayer's licensing of feature programs was taxable under s. 77.52, Wis. Stats., is reversed. This matter is remanded to the department for a determination of the amount of refund to which the taxpayer is entitled, not to exceed the amount of $961,072.14, plus interest.

The department has appealed this decision to the Circuit Court.

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Water conditioners. *Irvin Kozlovsky vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, January 15, 1987). The primary issue before this Commission is whether the taxpayer provided a nontaxable water conditioning service or rented tangible personal property subject to sales and use tax. A secondary issue is whether the salt sold and delivered by the taxpayer to his customers is the sale of tangible personal property subject to sales and use tax. During the period involved the taxpayer owned and operated, as a sole proprietor, a business known as Culligan Water Conditioning of Waupaca.

During the period involved the taxpayer provided water purification and conditioning, i.e., water softening for his customers, by two means: portable exchange units and automatic water conditioning systems.

The portable exchange units consist of a self-contained tank that when installed by the taxpayer, at his customer's location, purifies, conditions and softens the water it is connected to, through an ionic exchange, which removes calcium and replaces it with sodium. This tank is replaced by the taxpayer periodically, normally every 28 days, when its cycle is completed or when it loses its effectiveness. The old tank or unit is then cleaned, sterilized, and regenerated by the taxpayer and used again. This method was only available on a rental basis.

The second means used by the taxpayer to provide soft water to his customers was the installation, by the taxpayer at his customer's location, of a more permanent automatic water conditioning system which utilized the same ionic exchange but consisted of one tank that removed minerals and another to store salt. It was completely maintained and serviced by the taxpayer and was available on either a rental or purchase basis.

The customer had no control over the operation of the water conditioning equipment including the replacement of salt. He instructed his customers not to touch the equipment and provided a Watts telephone line in the event problems arose. None of his customers were provided a service manual. If a customer rented an automatic unit he or she was required to purchase and use the taxpayer's salt. There was no separate charge for the brine used to regenerate the portable units.

The Commission concluded that the use of a properly generated and efficiently functioning water softening apparatus (not the taxpayer's personal services) was the primary motivation of the taxpayer's customers and thus the providing of portable exchange units and automatic water softeners to those customers for a monthly fee is the rental of tangible personal property within the intent and meaning of s. 77.51(4)(j), Wis. Stats. The gross receipts received from the rental of tangible personal property at retail are subject to taxation under the provisions of s. 77.52(1), Wis. Stats. The salt sold and delivered to customers constitutes the sale of tangible personal property and is subject to taxation under the provisions of s. 77.52(1), Wis. Stats.

The taxpayer has appealed this decision to the Circuit Court.

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HOMESTEAD CREDIT

Property taxes accrued—joint ownership. *Myrtle Berglin vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, January 26, 1987). The issue pending before the Commission is whether the department was correct in making the adjustment to the amounts allowed for property taxes accrued and rent constituting property taxes accrued for the claimant's 1985 homestead credit claim.

During the entire year of 1985, Myrtle L. Berglin and Gustav Berglin (her brother) were listed on the title to the real estate located at 921 Ellis Avenue, Ashland, Wisconsin 54806, as the owners of record in joint tenancy. This property is the property on which the claimant's homestead credit claims are based. The real estate tax bills for the homestead for the year in question show the property owners as Myrtle and Gustav Berglin. The claimant paid all of the real estate taxes on the real property during the period in question.

In the notice explaining the adjustment in the amount of the claimant's 1985 homestead credit claim, the department adjusted the amount shown on the homestead credit claim form for taxes and rent paid by reducing the property tax amount to one-half of the net general tax paid. The department also allowed the claimant to claim an additional 25% of the real estate taxes paid as rent constituting property tax accrued for 1985 because Gustav Berglin did not reside in the homestead.

The Commission concluded that during the period under review, the claimant was deemed to have an ownership interest of only 50% in the homestead in question, as record title to the homestead was held jointly by her with her brother. Even though the claimant paid the entire 1985 property tax bill, as one of the two joint owners on the homestead, under the provisions of s. 71.09(7)(a)8, Stats., she was entitled to claim as her 1985 property taxes accrued only 50% of the 1985 taxes, rather than 100% of the 1985 taxes. The department acted properly when it adjusted the claimant's 1985 property taxes accrued to 50% of the tax bill on the homestead plus 25% of the remaining 50% of the 1985 tax bill as rent constituting property taxes accrued.

The claimant has not appealed this decision.

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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.)

The following Tax Releases are included:

Individual Income Taxes

Corporation Franchise/Income Taxes

Sales/Use Taxes

County Sales/Use Taxes

INDIVIDUAL INCOME TAXES

1. Limitations on Farm Losses

Statutes: Section 71.05(1)(a)26, 1985 Wis. Stats.

Note: This Tax Release applies only with respect to taxable years 1986 and thereafter.

Background: Section 71.05(1)(a)26 was created by 1985 Wisconsin Act 29. The new add modification limits the amount of combined net losses, exclusive of net gains, from farming businesses which may be claimed on the Wisconsin income tax return. Losses under sections 1211 (capital losses) and 1231 (loss on the sale or other disposition of property used in a trade or business) of the Internal Revenue Code are disregarded. Farm losses will be added back to arrive at Wisconsin taxable income to the extent:

a) farm losses are greater than $20,000 if nonfarm Wisconsin adjusted gross income is greater than $55,000 but not greater than $75,000, or
b) farm losses are greater than $17,500 if nonfarm Wisconsin adjusted gross income is greater than $75,000 but not greater than $100,000, or
c) farm losses are greater than $15,000 if nonfarm Wisconsin adjusted gross income is greater than $100,000 but not greater than $150,000, or
d) farm losses are greater than $12,500 if nonfarm Wisconsin adjusted gross income is greater than $150,000 and not greater than $200,000, or

e) farm losses are greater than $10,000 if nonfarm Wisconsin adjusted gross income is greater than $200,000 and not greater than $250,000, or
f) farm losses are greater than $7,500 if nonfarm Wisconsin adjusted gross income is greater than $250,000 and not greater than $300,000, or
g) farm losses are greater than $5,000 if nonfarm Wisconsin adjusted gross income is greater than $300,000 and not greater than $400,000, or
h) farm losses are greater than $0 if nonfarm Wisconsin adjusted gross income is greater than $400,000.

Facts and Question 1: Losses are limited if they are incurred in the operation of a farming business. What is considered "farming"?

Answer 1: Section 71.05(1)(a)26, 1985 Wis. Stats., states that farming is defined in section 464(e)1 of the Internal Revenue Code. Under this section of the Code, "farming" means:

> "the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity including the raising, shearing, feeding, caring for, training, and management of animals. For purposes of the preceding sentence trees (other than trees bearing fruit or nuts) shall not be treated as an agricultural or horticultural commodity."

Facts and Question 2: Will the farm loss rules apply to Christmas tree farms whereby every year there is a Schedule F loss pursuant to an election under section 631(a) of the Internal Revenue Code creating an offsetting (and related) gain on federal Schedule 4797?

Answer 2: No. Section 71.05(1)(a)26, 1985 Wis. Stats., provides that farming is defined in IRC section 464(e)(1) for purposes of applying the farm loss limitations. Section 464(e)(1) states that farming does not include raising or harvesting trees other than fruit or nut-bearing trees. Therefore, raising or harvesting of Christmas trees is not considered farming and the losses from such activities are not limited.

Facts and Question 3: In determining net losses incurred in the operation of a farming business for purposes of s. 71.05 (1)(a)26, 1985 Wis. Stats., do net losses include only those amounts that are properly reportable on federal Schedule F?

Answer 3: No. A part of the net loss from farming may be reported somewhere other than on Schedule F. For example, a gain or loss from a raised dairy calf that is less than 2 years old would be reported in Part 2 of 1986 federal Form 4797 and carried directly to line 15 of a sole proprietor's 1986 federal Form 1040 (a raised dairy calf that is less than 2 years old is not a section 1231 asset and thus should be included in computing the net farm loss). Also, a net loss from farming received by a partner, a shareholder in an S corporation, or a beneficiary of an estate or trust is reported on federal Schedule E.

Facts and Question 4: Assume a Wisconsin farmer has the following income and loss for 1986:

Nonfarm Wisconsin adjusted gross income	$ 60,000
Schedule F, net farm loss	$(450,000)*
Interest income on funds held to provide capital for farm expenditures	$ 5,000

*Includes interest expense of $1,000 on loans taken out to provide capital for farm expenditures.

How is the add modification under s. 71.05(1)(a)26, 1985 Wis. Stats., computed?

Answer 4: The s. 71.05(1)(a)26, 1985 Wis. Stats., add modification is calculated as follows:

Schedule F loss	$(450,000)
Related interest income	5,000
Combined net losses from a farm business	$(445,000)
Amount allowed under s. 71.05(1)(a)26, 1985 Wis. Stats.	20,000
Add modification	$(425,000)

The interest income and interest expense are included in computing the net loss from farming since they arose in the regular course of the taxpayer's farm business. Interest income that may be considered as income arising in the regular course of the taxpayer's farm business includes interest from a NOW checking account used for farm business and interest on money held for a down payment on farm equipment.

Facts and Question 5: A taxpayer has wages of $60,000 and a Schedule F farm loss of $40,000 in 1986. Also in 1986, the taxpayer sold his farm on a land contract and received interest income in regard to the sale of $20,000. This was the only farm the taxpayer operated. The taxpayer sold the farm to get out of the business of farming. Is the interest income considered farm-related income that may be used to compute the combined net losses from a farm business under s. 71.05(1)(a) 26, 1985 Wis. Stats?

Answer 5: No. The interest income received by the taxpayer in 1986 is considered to be nonfarm income. There is no farm business purpose in regard to the sale because the taxpayer is getting out of the farming business. The taxpayer is required to make an add modification of $22,500 ($40,000 Schedule F farm loss minus $17,500 loss limit) because nonfarm adjusted gross income is greater than $75,000 but not greater than $100,000.

Facts and Question 6: Assume the same facts as in Question 5 except that the taxpayer operates two farms. Because the taxpayer was experiencing economic problems, he sold one farm in order to obtain the operating capital necessary to continue operating the other farm. Is the interest income considered farm-related income that may be used to compute the combined net losses from a farm business under s. 71.05(1)(a)26, 1985 Wis. Stats.?

Answer 6: Yes. The interest income is considered to be farm-related income. The Schedule F farm loss of $40,000 minus farm-related interest income of $20,000 is not greater than $20,000; therefore, the taxpayer is not subject to the farm loss limitation rules.

Facts and Question 7: Assume a Wisconsin farmer has the following income and losses for 1986:

Nonfarm Wisconsin adjusted gross income	$ 60,000
Farm #1- S Corporation	$(500,000)
Farm #2- Schedule F, net farm profit	$ 200,000
Farm #3- Partnership	$ (35,000)

How is the add modification under s. 71.05(1)(a)26, 1985 Wis. Stats., computed?

Answer 7: The s. 71.05(1)(a)26, 1985 Wis. Stats., add modification is calculated as follows:

Farm #1 loss	$(500,000)
Farm #3 loss	(35,000)
Combined net losses from a farm business	$(535,000)
Amount allowed under s. 71.05(1)(a)26, 1985 Wis. Stats.	20,000
Add modification	$(515,000)

The losses from Farms #1 and #3 are not reduced by the amount of net profit from Farm #2 because the law provides for a modification for combined net losses, exclusive of gains.

Facts and Question 8: Assume the same facts as in Question 7. What is the taxpayer's Wisconsin adjusted gross income?

Answer 8: The taxpayer's Wisconsin adjusted gross income is computed as follows:

Federal adjusted gross income	$(275,000)
Wisconsin add modification	515,000
Wisconsin adjusted gross income	$ 240,000

Facts and Question 9: A Wisconsin farmer has the following income and losses for 1986:

Nonfarm Wisconsin income before net operating loss carryforward	$ 60,000
Wisconsin net operating loss carryforward from 1985 (includes farm losses from 1985)	$(300,000)

Is an add modification required for Wisconsin tax purposes for the amount of farm losses included in the net operating loss carryforward that will be used in 1986 ?

Answer 9: No. Section 71.05(1)(a)26, 1985 Wis. Stats., first applies to losses incurred in 1986. Therefore, if a net operating loss carryforward from 1985 includes a net loss from farming, that loss can be carried forward without modification.

Facts and Question 10: A Wisconsin farmer has the following income and losses for 1986:

Nonfarm Wisconsin income before net operating loss carryforward	$100,000
Wisconsin net operating loss carryforward from 1985	$ (50,000)
Schedule F farm loss	$ (40,000)

Is an add modification required for Wisconsin tax purposes?

Answer 10: No. The Wisconsin net operating loss carryforward from 1985 is considered nonfarm income; therefore, nonfarm adjusted gross income is $50,000 ($100,000 – $50,000). Since nonfarm adjusted gross income is less than the $55,000, no modification is required.

Facts and Question 11: Assume two Wisconsin farmers have the following income and losses for 1986:

	Farmer 1	Farmer 2
Nonfarm Wisconsin adjusted gross income	$ 60,000	$ 60,000
Farm #1-S Corporation (not including gain or loss below)	$(500,000)	$(500,000)
Farm #2-Schedule F, net farm profit	$ 200,000	$ 200,000
Farm #3-Partnership	$ (35,000)	$ (35,000)
Section 1231 loss-Farm #1 equip.	$ (10,000)	
Section 1231 gain-Farm #1 equip.		$ 10,000

How is the add modification under s. 71.05(1)(a)26, 1985 Wis. Stats., computed?

Answer 11: The s. 71.05(1)(a)26, 1985 Wis. Stats., add modification is calculated as follows:

	Farmer 1	Farmer 2
Farm #1 loss	$(500,000)	$(500,000)
Farm #3 loss	(35,000)	(35,000)
Combined net losses from a farm business	$(535,000)	$(535,000)
Amount allowed under s. 71.05(1)(a)26, 1985 Wis. Stats.	20,000	20,000
Add modification	$(515,000)	$(515,000)

Section 71.05(1)(a)26, 1985 Wis. Stats., specifies that losses allowable under sections 1211 (capital losses) and section 1231 (loss on the sale or other disposition of property used in a trade or business) of the Internal Revenue Code are not considered in calculating the add modification. Therefore, Farmer 1 does not have to limit the section 1231 loss on the sale of farm equipment.

Section 71.05(1)(a)26, 1985 Wis. Stats., also specifies that combined net losses "exclusive of net gains" are used in calculating the add modification. Therefore, Farmer 2 may not offset the losses from Farm #1 and Farm #3 by the section 1231 gain on the sale of farm equipment.

Facts and Question 12: A Wisconsin farmer has the following income and losses for 1986:

Nonfarm Wisconsin adjusted gross income	$ 60,000
Farm #1-S Corporation	$(500,000)
Farm #2-Schedule F, net farm profit	$ 200,000
Farm #3-Partnership (not including gain below)	$ (35,000)
Farm #3-Ordinary income (recapture)	$ 10,000
Farm #3-Long-term section 1231 gain	$ 200,000

How is the add modification under s. 71.05(1)(a)26, 1985 Wis. Stats., computed?

Answer 12: The s. 71.05(1)(a)26, 1985 Wis. Stats., add modification is calculated as follows:

Farm #1 loss	$(500,000)
Farm #3 loss	(35,000)
Combined net losses from a farm business	$(535,000)
Amount allowed under s. 71.05(1)(a)26, 1985 Wis. Stats.	20,000
Add modification	$(515,000)

Under s. 71.05(1)(a)26, 1985 Wis. Stats., all section 1231 gain, including any ordinary income portion, is excluded from the computation of combined net losses from farming.

Facts and Question 13: A Wisconsin farmer reports the following transactions on federal Schedule D:

Section 1231 long-term capital gain from sale of farm asset	$10,000
Long-term capital loss from sale of nonfarm asset	(6,000)
Net long-term capital gain	$ 4,000
60% exclusion	(2,400)
Amount of long-term capital gain included in Wisconsin adjusted gross income	$ 1,600

What amount is used in computing nonfarm Wisconsin adjusted gross income under s. 71.05(1)(a)26, 1985 Wis. Stats.?

Answer 13: The gain from selling the farm asset is considered farm income. To compute nonfarm income, another federal Schedule D must be prepared excluding the gain from selling the farm asset.

Long-term capital loss from sale of nonfarm asset	$(6,000)
50% limitation	50%
Net long-term capital loss to be used in computing nonfarm Wisconsin adjusted gross income	$(3,000)

Facts and Question 14: A Wisconsin farmer owns two farms which she rents to another farmer. The owner of the farmland participates in the operation of Farm #1, but does not participate in the operation of Farm #2. Is the rental income or loss from Farm #1 and Farm #2 farm or nonfarm income or loss for purposes of computing the Wisconsin add modification under s. 71.05(1)(a)26, 1985 Wis. Stats.?

Answer 14: The rental income or loss from Farm #1 is farm income or loss. The rental loss from Farm #2 is nonfarm loss because the farmer did not participate in the operation of the farm. The rental loss from Farm #2 will reduce nonfarm income. However, rental income from Farm #2 is neither farm income nor nonfarm income and will not reduce the farm loss nor increase nonfarm income.

Facts and Question 15: A Wisconsin farmer rents his or her farm machinery and equipment to another farmer. Is the rental income or loss farm or nonfarm income or loss for purposes of computing the Wisconsin add modification under s. 71.05(1)(a) 26, 1985 Wis. Stats.?

Answer 15: The rental loss from the rental of farm machinery and equipment is nonfarm loss and will reduce nonfarm income for purposes of computing the Wisconsin add modification under s. 71.05(1)(a)26, 1985 Wis. Stats. The rental income is neither farm income nor nonfarm income and will not reduce the farm loss nor increase nonfarm income.

Facts and Question 16: A Wisconsin farmer does custom work for another farmer (plowing fields, thrashing grain, etc.). Is the income or loss from the custom work farm or nonfarm income or loss for purposes of computing the Wisconsin add modification under s. 71.05(1)(a)26, 1985 Wis. Stats.?

Answer 16: The income or loss from doing custom work by a farmer is farm income or loss.

Facts and Question 17: How are the dollar limits specified in s. 71.05(1)(a)26, 1985 Wis. Stats., applied for married persons filing separately?

Answer 17: The dollar limits which apply to married persons filing separately are one-half of the limits which apply to married persons filing jointly.

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2. Married Couple Credit-Computing Earned Income

Statutes: Sections 71.05(1)(a)26, 71.07 and 71.09(7m), 1985 Wis. Stats.

Background: Section 71.09(7m), 1985 Wis. Stats., provides a credit of 2.5% of the earned income of the spouse with the lower earned income not to exceed $450. For purposes of this credit, earned income means wages, salaries, tips, other employee compensation and net earnings from self-employment allocable to Wisconsin under s. 71.07, 1985 Wis. Stats.

Question 1: An Indian living and working on her tribal reservation in Wisconsin receives wages of $10,000 which is not taxable for Wisconsin income tax purposes. Are the wages considered earned income for purposes of the married person's credit?

Answer 1: Yes. Under s. 71.07, 1985 Wis. Stats., the wages are allocable to Wisconsin even though such income is not taxable because of overriding federal treaties and statutes.

Question 2: A taxpayer has wages of $45,000 and a net farm loss of $48,000 in 1986. His spouse has wages of $20,000. For Wisconsin income tax purposes the taxpayer's farm loss is limited under s. 71.05(1)(a)26, 1985 Wis. Stats., to $20,000 because joint nonfarm income of the taxpayer and spouse ($45,000 + $20,000) is greater than $55,000. What is the taxpayer's earned income for purposes of the married person's credit?

Answer 2: Earned income includes the net earnings from self-employment. Therefore, the taxpayer must use the **net** loss from self-employment in computing earned income. The net loss from self-employment for Wisconsin is the federal farm loss ($48,000) adjusted for the add modification of $28,000 required for Wisconsin tax purposes, or $20,000. Therefore, earned income of the taxpayer would be $25,000 ($45,000 – $20,000). Because the taxpayer's spouse has the lower earned income ($20,000), that amount is used in computing the Wisconsin married person's credit.

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3. Tier 1 Railroad Retirement Benefits

Statutes: Section 71.05(1)(b)4, 1985 Wis. Stats.

Note: This Tax Release applies only to the 1986 taxable year and thereafter.

Background: Title 45 USC 231m of the United States Code bars state and local taxation of railroad retirement benefits. However, railroad retirement benefits may be taxable for federal income tax purposes.

Section 71.05(1)(b)4, 1985 Wis. Stats., provides a subtraction modification which may remove any railroad retirement benefits included in federal adjusted gross income, when computing Wisconsin taxable income. Social security benefits are taxable for Wisconsin income tax purposes. Also, tier 1 railroad retirement benefits are combined with social security benefits to determine any taxable amount for federal purposes.

Question: Since the amount of taxable social security and railroad retirement benefits included in federal adjusted gross income is determined on the basis of the aggregate benefits received from both sources, how should the amount of railroad retirement benefits included in federal adjusted gross income be determined for purposes of the Wisconsin subtraction modification?

Answer: The following formula should be used to determine what portion of combined social security and railroad retirement benefits included in federal adjusted gross income is attributable to **only** railroad retirement benefits:

Amount of railroad retirement benefits included on line 21a, 1986 Form 1040 / Total amount entered on line 21a,1986 Form 1040	x	Amount from line 21b, 1986 Form 1040	=	Amount of railroad retirement benefits that may be claimed as a subtraction modification on line 4 Wisconsin 1986 Form 1

Example: A single taxpayer has the following income in 1986:

Interest	$21,000
Dividends	4,000
Social Security (Form SSA-1099)	5,000
Railroad Retirement (Form RRB-1099)	10,000
Total	$40,000

The taxpayer computes the taxable amount of combined social security and railroad retirement benefits to be $3,750 and reports it on line 21b of federal 1986 Form 1040. The taxpayer may claim a subtraction modification on line 4 of 1986 Wisconsin Form 1 of $2,500, computed as follows using the above equation:

$$\frac{\$10,000}{\$15,000} \times \$3,750 = \$2,500$$

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CORPORATION FRANCHISE/INCOME TAXES

1. "No Tax Change" Field Audits

Statutes: Sections 71.09(13)(a), 71.10(10), 71.11(20) and (21)(a), 71.12 and 77.59(8m), 1985 Wis. Stats.

Note: This Tax Release supersedes the Tax Release titled" 'No Tax Change' Field Audits" which appeared in WTB 42. Changes have been made to the Background and to Answer 12 of the prior Tax Release.

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), 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.

However, for sales tax purposes, the Wisconsin Supreme Court held in the case of *Moebius Printing Company* (89 Wis 2d 610 (1979)) that a "no change" letter issued by the department constituted a field audit per s. 77.59(2), Wis. Stats. While the no change letter did not meet all the statutory requirements (s. 77.59(3)) of a "notice of determination," it was deemed such a notice because it was "in substantial compliance" with the statute.

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 assessment per s. 71.11(21)(a), 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 or any other statute?

Answer 2: No. A taxpayer may not seek the appeal remedies specified in s. 71.12, 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 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.*, 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), 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), 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, 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 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), 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 reported in that tax year considered to be final and conclusive under s. 71.09(13)(a), s. 71.10(10)(d), 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), Wis. Stats.

Sales and Use Tax

Question 12: What is the effect of a "no change" sales/use tax field audit?

Answer 12: For sales and use tax purposes, unless appealed, a field audit "no change" letter issued prior to April 30, 1986, does finalize those years for which there is no change, and no adjustments (claims for refund, amended return, etc.) may be made to such years by the taxpayer or the department (*Moebius Printing Co*). Effective for "no change" letters issued on or after April 30, 1986, and under s. 77.59(8m), Wis. Stats., created by 1985 Wisconsin Act 261, a claim for refund may be filed within 4 years after the due date of the taxpayer's Wisconsin income or franchise tax return, or if exempt from filing a Wisconsin income or franchise tax return, within 4 years of the 15th day of the 4th month of the year following the close of the calendar year or fiscal year even though a field audit "no change" letter was issued if (a) the taxpayer's customers have filed valid claims for refund with the taxpayer and (b) the refund is passed along by the taxpayer to the customers.

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2. The Effect of a Corporation's Interest in a Partnership on the Apportionment Formula

Statutes: Sections 71.07(1m)(b)14 and 15 and 71.07 (2)(a), (b), (cm)8 and (cr)15, 1985 Wis. Stats.

Wis. Adm. Code: Section Tax 2.39, September 1983 Register

Background Information: A partnership is defined as an association of two or more persons to carry on as co-owners a business for profit. Partnerships are not regarded under the Uniform Partnership Act as separate entities, but only as associations or contracts between the general partners. Partnerships are not taxed as separate entities either in Wisconsin or federally. General partners have liability for all of the debts incurred by the partnership, have equal rights in the management of the partnership, and rights in specific partnership property.

Limited partners in a limited partnership are not liable beyond the limited partner's contribution to the limited partnership and the limited partner's interest has been held to constitute intangible property analogous to a share in a corporation.

Some income from intangibles is included in apportionable income only if the operations of the payer are unitary with the payee or if derived from a unitary investment activity not involving an affiliate or a subsidiary. A partnership is not a legal or taxable entity apart from its general partners. In addition, a general partner's interest in a partnership is more than an interest in an intangible, because of the general partner's unlimited liability, control over the management of the partnership, and property interest in the partnership. Therefore, a general partner is deemed to always be involved in both a unitary relationship with the partnership and the partnership is deemed to always be the product of unitary investment activity. A corporate general partner's share of the income of a partnership is always apportionable income.

A limited partner's share of the income of a limited partnership is included in apportionable income if it is a product of the limited partner's unitary investment activity, i.e., its investment activities are an integral part of the other business activities.

Corporations doing business within and without Wisconsin, whose Wisconsin operations are an integral part of a unitary business, must apportion a part of their income to Wisconsin based on the three-factor apportionment formula of property, payroll, and sales. If the corporation is a general partner of a partnership, its share of the partnership's property, payroll, and sales are included in the various factors since they are deemed those of the corporate general partner. The same is **not** true if the corporation is a limited partner, with one exception. The exception is that the corporate limited partner may include income from a limited partnership it has included in apportionable income in its sales factor for years up through 1985.

Part I - Property Factor

Question 1: How will a corporation's interest in a general partnership affect the property factor of the apportionment formula?

Answer 1: A corporation's share of the partnership's tangible personal property or rental property is included in the denominator of the property factor. If the partnership has property in Wisconsin, the value of such property would be included in the numerator of the factor to the extent of the corporation's partnership ratio. For example, a corporation holding a 50% interest in a partnership will include 50% of the Wisconsin property in the numerator of its property factor.

Question 2: How will a corporation's interest in a limited partnership affect the property factor of the apportionment formula?

Answer 2: The investment in a limited partnership is intangible property; therefore, as an investor the corporation does not own any tangible partnership property. Therefore, the value of the property is not included in the numerator or denominator of the property factor.

Example: A multistate corporation has the following information in regard to its property factor:

Total company property of the corporation	$500,000
Wisconsin property of the corporation	$300,000
Total property of limited partnership in which the corporation holds a 50% interest	$100,000
Wisconsin property of the limited partnership	$ 10,000
Total property of general partnership in which the corporation holds a 50% interest	$ 50,000
Wisconsin property of the general partnership	$ 20,000

The numerator of the property factor would be $310,000, which is Wisconsin corporation property ($300,000) and 50% of the

Wisconsin general partnership property ($10,000). The denominator of the property factor would be $525,000, which is total company corporation property ($500,000) and 50% of the total general partnership property ($25,000). The amounts from the limited partnership would not be included in the factor.

Part II - Payroll Factor

Question 3: How will the Wisconsin payroll factor be affected for a corporation which is a general partner in a partnership that is paying wages to the partnership's employes and management fees to the partners?

Answer 3: Payment of wages to a general partnership's employes is included in the denominator of the corporation's payroll factor to the extent of the corporation's partnership ratio. For example, if a corporation holds a 30% interest in the partnership, 30% of the partnership payroll will be included in the denominator of the payroll factor. Payment of wages to a general partnership's Wisconsin employes is included in the numerator of the corporation's payroll factor to the extent of the corporation's partnership ratio. Payments to corporate partners for management services performed in Wisconsin are included in the numerator of the payroll factor to the extent of the partnership ratio. The denominator of the payroll factor includes all management fees paid to corporate partners.

Question 4: How will the payroll factor be affected for a corporation which is a limited partner in a partnership that is paying wages to the partnership's employes?

Answer 4: The limited partnership interest is an intangible investment interest and the compensation paid by the limited partnership is not compensation paid by the corporation; therefore, such compensation is not included in the numerator or denominator of the payroll factor.

Example: A corporation has the following information in regard to its payroll factor:

Total company payroll of the corporation	$1,000,000
Wisconsin payroll of the corporation	$ 500,000
Total payroll of a limited partnership in which the corporation holds a 50% interest	$ 50,000
Wisconsin payroll of the limited partnership	$ 20,000
Total payroll of a general partnership in which the corporation holds a 50% interest	$ 100,000
Wisconsin payroll of the general partnership	$ 40,000
Management fees paid by the general partnership to the partners for services performed in Wisconsin	$ 20,000

The numerator of the payroll factor would be $530,000, which is the corporation's Wisconsin payroll ($500,000) and 50% of the general partnership Wisconsin payroll and management fees paid ($30,000). The denominator of the payroll factor would be $1,060,000, which is the corporation's total company payroll ($1,000,000), 50% of the general partnership's total payroll ($50,000) and 50% of the management fees paid ($10,000).

Part III - Sales Factor

Question 5: How will a corporation's interest in a general partnership affect the sales factor?

Answer 5: The corporation's share of partnership gross receipts is included in the numerator and denominator of the sales factor under the same conditions as the corporation would handle its own gross receipts. For example, sales are treated on a destination basis and all rules regarding throwback sales will apply. Sales made by the partnership to the corporate partner are not included in the numerator or denominator of the sales factor because they are considered intercompany transfers. The third party gross receipts of the partnership will only be included in the numerator or denominator to the extent of the corporate partner's interest in the partnership. For example, if a corporation holds a 60% interest in the partnership, 60% of the Wisconsin and total company gross receipts will be included in the corporation's numerator and denominator of the sales factor.

Question 6: How will a corporation's interest in a limited partnership affect the sales factor?

Answer 6: **1986 taxable year and thereafter** - Neither the corporation's share of the gross receipts or of the income or loss of a limited partnership are included in the numerator or denominator of the sales factor by the corporate partner. (s. 71.07(2)(cr), 1985 Wis. Stats.)

1985 taxable year and prior - Corporations have an option in computing the sales factor for taxable years prior to 1986 that are open for assessment or refund. Corporations may or may not include all income from intangibles, included in apportionable income, in the numerator and denominator of the sales factor. If intangible income is included, only the distributive share of the limited partnership income — not loss — is to be included. If the option is exercised, all income from intangibles, included in apportionable income, would be excluded from the sales factor. (For additional information, see the tax release titled "Sales Factor: Items of Income Includable" in Wisconsin Tax Bulletin 46.)

Example 1: A corporate partner in a limited partnership has the following information in regard to its sales factor for the 1985 taxable year.

Total company sales by the corporation	$200,000,000
Wisconsin sales by the corporation	$ 10,000,000
Total sales by the limited partnership in which the corporation has a 50% interest (to third parties)	$ 1,000,000
Wisconsin sales by the limited partnership (to third parties)	$ 500,000
Sales by the limited partnership to the corporation	$ 100,000

If the option mentioned above is not exercised, the numerator would be $10,250,000 which is Wisconsin sales by the corporation ($10,000,000) and 50% of Wisconsin sales by the limited partnership to third parties ($250,000). The denominator would

be $200,500,000, which is total company sales by the corporation ($200,000,000) and 50% of total sales by the limited partnership to third parties ($500,000).

If the option is exercised, the numerator would be $10,000,000 and the denominator would be $200,000,000.

Sales by the limited partnership to the corporation are not included in the sales factor under either option.

Example 2: Assuming the same facts as in Example 1, except that the information relates to the 1986 taxable year, the numerator would be $10,000,000 (Wisconsin sales by the corporation) and the denominator would be $200,000,000 (total company sales by the corporation). The corporation does not have an option in computing the Wisconsin sales factor for 1986. The sales factor will not include sales from a limited partnership. (s. 71.07(2)(cr), 1985 Wis. Stats.)

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SALES/USE TAXES

1. Food Service Charges (Costs and Management Fee Reimbursed)

Statutes: Section 77.51(14)(f), 1985 Wis. Stats.

Wis. Adm. Code: Section Tax 11.87, September 1984 Register

Facts and Question: A food service provider ("P") provides food service to a manufacturer's ("M") guests at a motel-like facility. At this facility "M" provides lodging and food to guests at no cost to the guests. The only amount paid "P" for the food service comes from "M". The contract between "P" and "M" provides that "P" is an independent contractor.

"P" provides the personnel and purchases, stores, prepares and serves the food. Menu selections are made in advance and agreed upon between the parties. "M" provides the facilities and equipment, including dining room furniture and furnishings, kitchen equipment, china and silverware. "P" is responsible for cleaning this equipment. "M" pays "P" all the direct costs of this food service plus a management fee of 10% of the direct costs.

Is the payment by "M" to "P" subject to the sales tax?

Answer: Yes. The amounts paid by "M" to "P" are taxable gross receipts from the sale of meals under s. 77.51(14)(f), 1985 Wis. Stats., which provides that "sale" includes "the furnishing, preparing or serving for consideration of food, meals, confections or drinks."

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2. Industrial Waste Treatment Facility-Air Stripping System Doesn't Qualify For Exemption

Statutes: Sections 70.11(2) and (21)(a) and 77.54(26), 1985 Wis. Stats.

Wis. Adm. Code: Sections Tax 6.40 and 12.40 (both March 1980 Register) and Section Tax 11.11, September 1984 Register

Facts and Question: A construction company has been awarded a contract by the U.S. Army Corps of Engineers to build an air stripping system on the municipal well field owned by a city in Wisconsin. The project encompasses the construction of water treatment facilities to remove volatile organic contaminants (VOC) from the ground water obtained from the municipal well field. The contractor is installing an air stripping system which consists of pumps, motors, treatment equipment, instrumentation and controls, piping and packed stripping towers in a pre-fabricated metal building.

The air stripping system upon its completion will be transferred to the city. The property is exempt from real estate tax under s. 70.11(2), 1985 Wis. Stats., because it is owned by the city. However, the contractor needs a determination if this facility is a waste treatment facility in order to decide if it is entitled to a sales tax exemption under s. 77.54(26), 1985 Wis. Stats., on its purchases of tangible personal property for construction of the project. The taxpayer suggested that the project qualifies as an industrial waste treatment facility because it will treat VOC which are in the well field and that such VOC's are a liquid waste resulting from a process of industry years ago.

Does this entire facility, equipment and building, qualify for the sales/use tax exemption as a waste treatment facility under s. 77.54(26), 1985 Wis. Stats.?

Answer: No. This air stripping system is not a waste treatment facility qualifying for a sales/use tax exemption under s. 77.54(26), 1985 Wis. Stats. The exemption applies to waste treatment facilities, not to drinking water purification plants, whether operated by a city or some other person.

However, the contractor may purchase the items of tangible personal property without tax for resale, which are resold to the U.S. Army Corps of Engineers as tangible personal property. This would include all the processing equipment used to purify the water, but it does not include the materials used to construct the building which houses the equipment, because these materials are consumed by the contractor in constructing a building which is a realty improvement.

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3. Reseller's Purchases of Equipment and Access Services

Statutes: Section 76.38(1)(c), 77.51(13)(p) and (14)(m) and 77.54(24), 1985 Wis. Stats.

Wis. Adm. Code: Section Tax 11.66(2), January 1983 Register

Facts and Question: A reseller of long-distance telecommunication services purchases telephone services from carriers. It also purchases access services from local telephone companies which permit it to reach its customers to originate and terminate telephone messages.

Section 77.51(13)(p), 1985 Wis. Stats., provides that a "retailer" includes "A telephone company which provides to an interexchange carrier services which permit the origination or termination of telephone messages between a customer in this state and one or more points in another telephone exchange."

To utilize the reseller's service a customer must call a central number, give an access code and then dial the desired number. The company utilizes a central switching service to connect the customer with the desired number. The calls coming through the reseller's system utilize the nearby local telephone company's switch.

Statute 77.54(24), 1985 Wis. Stats., provides a sales/use tax exemption for central office equipment of telephone companies used in transmitting traffic and operating signals. This reseller's equipment consists of switching equipment and computer equipment. The company also has computer terminals and equipment in their corporate headquarters used to record call detail and check the routing of calls. This computer is also used in its accounting system.

Section 76.38(1)(c), 1985 Wis. Stats., effective January 1, 1986, provides that a "telephone company" means "any person operating a telecommunications facility or providing telecommunications services to another person, including the resale of those services provided by another telephone company....". Because of the change, resellers became subject to the telephone license fee under Chap. 76 in 1986, based on 1985 revenues. Resellers were not considered telephone companies under Chap. 76 prior to January 1, 1986.

Section 76.38(1)(bkm), 1985 Wis. Stats., provides in part "'qualifying telecommunications reseller' means a company that provides local or rural exchange service and does not own, operate, manage or control transmission facilities for toll business outside the exchanges in which the public service commission has authorized them to provide local or rural services or a telephone company that fulfills all the following requirements:

1. Resells message telecommunications service, wide-area telecommunications services or other telecommunications services which have been approved for reselling by the public service commission or by the federal communications commission.

2. Does not own, operate, manage or control transmission facilities that have the technological capability to provide telecommunications service within this state."

Is a telecommunications reseller required to pay sales or use tax on its purchases of switching equipment and access services?

Answer: A reseller is required to pay sales or use tax on its purchases of switching equipment. The exemption in s. 77.54(24), 1985 Wis. Stats., does not apply to a reseller's switching equipment because a reseller does not own, operate, manage or control transmission facilities. Section 77.54(24), 1985 Wis. Stats., only provides an exemption for central office equipment used in "transmitting traffic and operating signals." A reseller also is required to pay sales tax on its purchases of access services from the local telephone company because it is a telecommunication interexchange carrier as defined in s. 77.51(13)(p), 1985 Wis. Stats.

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COUNTY SALES/USE TAXES

1. County Tax: "Similar Local Tax in Another State"

Statutes: Section 77.71(2), 1985 Wis. Stats.

Facts and Question: Section 77.71(2), 1985 Wis. Stats., provides that "An excise tax is imposed at the rate of 0.5% of the sales price upon every person storing, using or otherwise consuming in the county tangible personal property or services if the property or service is subject to the state use tax under s. 77.53 ... except that if the buyer has paid a similar local tax in another state on a purchase of the same property or services that tax shall be credited against the tax under this subsection."

What does "similar local tax in another state" mean?

Answer: The reference to a "similar local tax in another state" means either a local sales tax or local use tax measured by a percentage of gross receipts or sales price. It would not refer to all local excise taxes but only to local excise taxes imposed as sales or use taxes. "Local taxes" would include both city and township sales or use taxes of other states.

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2. Definition of "Contractor" in County Sales/Use Tax Law

Statutes: Section 77.71(3), 1985 Wis. Stats.

Facts and Question: Section 77.71(3) 1985 Wis. Stats., imposes a county excise (use) tax upon a "contractor who is engaged in construction activities within the county" on property that is used in constructing, altering, etc. real property that becomes a component part of the real property in that county.

Question: Does "contractor" as used in s. 77.71(3) 1985 Wis. Stats., include persons who are not generally in the construction business but may on occasion or very infrequently engage in construction activities such as building their own home. For example, a person works for the government full time as a wage earner during the week, but decides to build a home and act as his

own contractor during "nonwork" hours. He purchases building materials, etc. for the purpose of constructing the home.

Answer: Yes, such persons are considered contractors. Section 77.71(3), 1985 Wis. Stats., imposes a county excise (use) tax upon a contractor engaged in construction activities within a county which has adopted the tax.

The key to the tax imposition is that the materials are used in construction activities, no matter who purchases the building materials. Anyone engaged in construction activities is considered a contractor even though that is a minor part of the person's activities. For example, if a large retailer sells and then has carpeting installed in a household, it is a contractor who must pay tax on its cost of materials.

Therefore, s. 77.71(3), 1985 Wis. Stats., imposes a tax on any person using building materials in construction activities within a county which has adopted the tax, whether that person is in the construction business or not. A person who remodels or repairs his or her own residence is liable for tax under s. 77.71(3), 1985 Wis. Stats., just as a business person is subject to this 1/2% county tax on building materials which become a component part of real property.

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3. Manufacturer's Franchise/Income Tax Credit For County Sales Tax Paid on Fuel and Electricity Purchased

Statutes: Sections 71.043 and 77.79, 1985 Wis. Stats.

Wis. Adm. Code: Section Tax 2.11, September 1983 Register

Facts and Question: Section 71.043(2), 1985 Wis. Stats., provides: "The tax imposed upon or measured by corporation net income of the taxable year 1973 and subsequent taxable years pursuant to s. 71.01(1) or (2) may be reduced by an amount equal to the sales and use tax under ch. 77 paid by the corporation in such taxable year on fuel and electricity consumed in manufacturing tangible personal property in this state."

The county sales and use tax is imposed under Subchapter 5 of Chapter 77.

Does s. 71.043(2), 1985 Wis. Stats., provide a manufacturer with a Wisconsin franchise or income tax credit for county sales and use taxes paid on fuel and electricity purchased which is consumed in manufacturing?

Answer: Yes. The county sales and use taxes paid on fuel and electricity consumed in manufacturing may be used to offset Wisconsin corporation franchise or income tax computed on Form 4 or 5, the Corporation Franchise or Income Tax Return, as provided under s. 71.043, 1985 Wis. Stats.

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