WISCONSIN TAX BULLETIN

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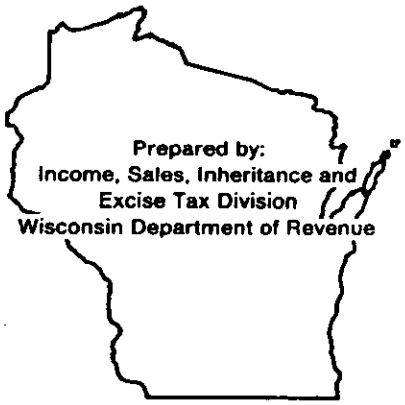

SPECIAL TAX FORMS FOR CERTAIN FISCAL YEAR FILERS

A Wisconsin tax law change included in 1989 Wisconsin Act 31 federalized the definition of "taxable year." "Taxable year" now means the taxable period upon the basis of which the taxpayer's taxable income is computed for federal income tax purposes.

As a result of this law change, taxpayers will file a 1989 return for Wisconsin purposes for any taxable year that begins in 1989, the same as for federal purposes. (Under prior law, a 1989 Wisconsin return would be filed for any year that ends after July 1, 1989, and before July 1, 1990.)

This law change applies for taxable years that begin on or after August 1, 1988. Therefore, taxpayers whose fiscal years begin in August through December 1988 and end in July through November 1989, must file two 1988 returns for different taxable periods. To distinguish between these two returns, the forms and instructions refer to the first return as a "1988" return and the second as a "1988F" return. The first 1988 return, which should have been filed previously on the 1988 forms, was for the year that ended after July 1, 1988, and before December 31, 1988. The second, which will be filed on the 1988F forms, will be for the year that ends after July 1, 1989, and before December 31, 1989.

IN THIS ISSUE

The change in definition of taxable year does not change a taxpayer's fiscal year, nor does it require the filing of a short period return.

Taxpayers whose taxable years end in any months other than July through November 1989 are not affected by this law change and need not file any special returns.

Corporations

The Forms 4, 5, 5S, and the supplemental Forms 4B, 4BL, 4C, and 4U, and Schedule 5K-1 and R all have a "1988F" version. Taxpayers who filed 1988 forms with a July, August, September, October, or November year end will automatically be sent the 1988F forms. Additional forms may be obtained by calling (608)266-1961. It is estimated that 14,000 corporations will file a 1988F form.

There will not be special estimated tax vouchers for these fiscal year taxpayers. Instead, a second set of 1989 vouchers should be used. Corporations which made estimated tax payments for their years ending in 1989 will be sent estimated tax vouchers.

Individuals

Individuals whose taxable year ends after July 1, 1989, and before December 31, 1989, will also be sent special forms (Form 1 or Form 1NPR) and a letter explaining how to file a second 1988 return. It is estimated that fewer than 100 individuals

will be required to file a second 1988 return.

Estates and Trusts

Due to the small number of estates and trusts that will be required to file two 1988 returns, no special Form 2 is being prepared. Affected taxpayers should be advised to write "2nd 1988 return" at the top of the second 1988 Form 2 they file.

Partnerships

The Form 3 and Schedule 3K-1 will have a 1988F version to be filed by partnerships with fiscal years ending after July 1, 1989, and before December 31, 1989. The 1988F forms will be sent to partnerships which filed 1988 Form 3 with a July, August, September, October, or November year end. It is expected there will be 300 partnerships filing a 1988F form. Additional forms may be obtained by calling (608) 266-1961.

Exempt Organizations

The Form 4T will have a 1988F version to be filed by exempt organizations having unrelated business income with fiscal years ending after July 1, 1989, and before December 31, 1989. The 1988F 4T will be mailed to exempt organizations who have already filed a 1988 Form 4T. Additional copies may be obtained by calling (608) 266-1961.

NEW WISCONSIN TAX LAWS

The August 1989 issue of the Wisconsin Tax Bulletin (Items A.10. on page 4, A.20. on page 8, and B.21. on page 33) included descriptions of two bills (AB 60 and AB 233) which had been enacted by the Legislature but had not been signed by the Governor at the time the Bulletin went to print. Both of these bills were signed by the Governor on September 11, 1989.

1989 Wisconsin Act 44 (AB 60), which affects the development zone jobs credit is effective for business closings and layoffs that occur after September 11, 1989, for employers that employ 100 or more persons and on November 10 for employers employing fewer than 100 persons. 1989 Wisconsin Act 46 (AB 233), which provides an exemption for interest income from higher education bonds, is effective September 12, 1989.

GOVERNOR DESIGNATES DEVELOPMENT ZONES

As part of 1987 Wisconsin Act 328, a development zone program was created that would provide $14 million in state tax credits and technical assistance to businesses which locate or expand in a "development zone."

During the week of September 3, 1989, Governor Tommy Thompson named portions of Milwaukee, Beloit, Racine, Manitowoc, Sturgeon Bay, Superior, Iron County, and the Stockbridge-Munsee tribal community as the state's first development zones. The duration of each zone is 7 years.

The development zone program is administered by the Wisconsin Department of Development (DOD). To learn more about the program and specific locations of the zones, you may call Kathleen Heady, Department of Development, at (608) 267-2045 or call the following local development zone contacts:

Development Zone	Information
Beloit	Neal Herst Community Development Director (608) 364-6700
Iron County	Cathy Techtmann Iron County Resource Agent (715) 561-2695
Manitowoc	David Less City Planner (414) 683-4435
Milwaukee	Michael Brodd Manager of Planning & Analysis Department of City Development (414) 223-5800
Racine	Thomas Wright Director of City Development (414) 636-9151
Stockbridge-Munsee	Leah Miller-Heath Tribal Planner (715) 793-4111
Sturgeon Bay	Ed Allingham Sturgeon Bay City Administrator (414) 743-6263
Superior	James Kumbera Community Development Director (715) 394-0278

BULK ORDERS OF TAX FORMS

In early October, the department mailed the order blank (Form P 744) which tax preparers should use to request bulk orders of 1989 Wisconsin income tax forms. There is a handling charge on these orders.

In early October, the department also mailed order blanks (Forms P-744b and P-744L) which banks, post offices, and libraries should use to request bulk orders of 1989 Wisconsin income tax forms. No charge is made for forms used for distribution to the general public (for example, in a bank, library, or post office).

This year's mailing list for bulk order blanks contains the names of all persons and organizations who placed orders for 1988 forms. If you are not on this mailing list and do not receive a Form P-744, P-744b, or P-744L, you may request the bulk order blank by contacting any department office or by writing to the Wisconsin Department of Revenue, Shipping and Mailing Section, Post Office Box 8903, Madison, Wisconsin 53708. You may also call the Shipping and Mailing Section at (608) 267-2025.

Orders should be placed as early as possible after you receive the order blank. Orders received by November 10, 1989, will be mailed in late December and early January. Package WI-X will be mailed separately in late January.

NEW PUBLICATION ON MARITAL PROPERTY LAW AVAILABLE

The Internal Revenue Service and Wisconsin Department of Revenue have coauthored a new publication titled *Federal and Wisconsin Income Tax Reporting Under the Marital Property Act*. This publication contains information about both the federal and Wisconsin treatment of separated and divorced spouses, as well as information about the collection of tax debts and the determination of the basis of property upon the death of a spouse. The "Federal Treatment" was written by Larry Phillips, District Director of the Milwaukee Office of the Internal Revenue Service, and the "Wisconsin Treatment" was written by Carol Held of the Wisconsin Department of Revenue. A copy of this joint publication is reproduced beginning on page 27 of this Bulletin.

INCREASE IN IRS STANDARD MILEAGE RATE ALSO APPLIES FOR WISCONSIN FOR 1989

The optional standard mileage rate specified by the IRS for computing business automobile expenses for 1989 also applies for Wisconsin. The IRS increased the rate from 24¢ to 25.5¢ for the first 15,000 business miles driven in an automobile that is not fully depreciated. After 15,000 miles of business use in one year and for all mileage on a fully depreciated automobile, the rate remains at 11¢ per mile. If the optional method for computing costs of business use of an automobile is used, depreciation is considered to be allowed at 11¢ per mile for 1989.

The mileage rate used to calculate automobile expenses for charitable deduction purposes, which remains at 12¢ a mile in 1989, also applies for Wisconsin.

For both federal and Wisconsin purposes, a rate of 9¢ per mile is used in 1989 to calculate automobile expenses for medical and moving expense deductions.

TAX RETURN STATISTICS FOR 1988-89

There were 2,396,000 Wisconsin individual income tax returns filed during the period July 1, 1988, to June 30, 1989. This compares to 2,357,000 income tax returns filed for the prior 12 months. The 2,396,000 returns were filed by 3,453,000 individuals.

There were 252,000 homestead credit claims and 24,000 farmland credit claims filed during the year. This compares to 263,000 homestead credit claims and 23,000 farmland credit claims filed for the prior year.

Taxpayers were issued a total of 1,719,200 income tax refunds during the 12 months ending June 30, 1989, for an average refund of $300. The average refund for the prior year was $329.

Homestead credit refunds averaged $400 per claimant, an increase from the average refund of $399 issued last year. About 50% of the claimants were age 65 or older. Of all individuals claiming homestead credit, 47% were renters and 53% were homeowners.

An average farmland preservation credit of $1,192 was issued to each claimant. The average payment last year was $1,286. Also, an average farmers' drought credit of $324 was issued to 56,000 farmers.

An itemized deduction credit was claimed by 20% of the taxpayers on 1988 tax returns. The average credit allowed was $279.

TAXPAYERS DESIGNATE $439,821 TO STATE ELECTION CAMPAIGN FUND

The 1988 Wisconsin income tax returns, Forms 1, 1A, 1NPR, and WI-Z, included a box for taxpayers to designate $1 to the State Election Campaign Fund. If the box was checked "yes," there was no increase in tax liability or reduction in refund for making the designation.

During the period July 1, 1988, to June 30, 1989, taxpayers designated $439,821 to the election campaign fund on their Wisconsin tax returns. This compares to $449,211 for the prior 12 months ending June 30, 1988.

CONTRIBUTIONS TO ENDANGERED RESOURCES PROGRAM INCREASE

The 1988 Wisconsin income tax returns, Forms 1, 1A, 1NPR, and WI-Z included a line for taxpayers to contribute to the Wisconsin Endangered Resources Fund. These donations either reduce a taxpayer's income tax refund or increase the amount of income tax owed. Amounts contributed go to the Wisconsin Department of Natural Resources to help protect and care for Wisconsin's endangered species, nongame wildlife, and rare plant and animal habitats.

On 1988 Wisconsin income tax returns filed, 56,893 taxpayers contributed $612,380 to the Endangered Resources Fund. This compares with 1987 income tax returns where 55,662 taxpayers contributed $533,712.

1989 PACKAGE WI-X WILL BE AVAILABLE

The department will again be offering Package WI-X which will contain actual size copies of most 1989 Wisconsin individual, fiduciary, and corporation income tax, gift tax, inheritance tax, motor fuel tax, sales tax, and withholding tax forms.

Package WI-X should be available by January 31, 1990. The cost is $6.00 per copy. It may be ordered on the bulk order blank (Form P-744). The bulk order blank was mailed in October. See the following article for more information on bulk orders.

If you do not receive an order blank and wish to purchase copies of 1989 Package WI-X, requests indicating the number of copies along with the amount due should

be mailed to: Wisconsin Department of Revenue, Shipping and Mailing Section, Post Office Box 8903, Madison, Wisconsin 53708.

REMINDER: FILING DEADLINES FOR 1988 HOMESTEAD AND FARMLAND PRESERVATION CREDIT CLAIMS

January 2, 1990, is the deadline for filing a 1988 homestead credit claim. Farmland preservation credit claims for 1988 must be filed no later than 12 months after the farmland owner's 1988 taxable year ends. January 2, 1990, is the deadline for filing a 1988 farmland preservation credit claim for farmland owners who are calendar year taxpayers.

No extensions of time are available for filing claims for these two credits.

REMINDER: NOTIFY DEPARTMENT OF FEDERAL ADJUSTMENTS AND AMENDED RETURNS

If a taxpayer's federal income tax return is adjusted by the Internal Revenue Service (IRS), and the adjustments affect the amount of Wisconsin income reportable or tax payable, such adjustments must be reported to the Wisconsin Department of Revenue within 90 days after they become final.

In addition, taxpayers filing an amended return with the IRS or another state must also notify the department within 90 days of filing if information in the amended return affects the amount of Wisconsin income reportable or tax payable.

For taxable years prior to 1987, if a taxpayer does not report adjustments made by the IRS or amended returns are not filed in the time period specified above, the department may make an assessment against the taxpayer or a refund to the taxpayer within 10 years after the date which the original tax return was filed or within 2 years after the date when the federal determination of tax became final, whichever is later.

For taxable years 1987 and thereafter, if a taxpayer does not report adjustments made by the IRS or amended returns are not filed in the time period specified above, the department may make an assessment against the taxpayer or a refund to the taxpayer within 4 years after discovery by the department.

An amended Wisconsin return or copy of the federal audit report should be sent to the Wisconsin Department of Revenue, Audit Bureau, Post Office Box 8906, Madison, Wisconsin 53708.

REMINDER: EMPLOYERS MUST SUBMIT COPIES OF CERTAIN EMPLOYE WITHHOLDING EXEMPTION CERTIFICATES

Wisconsin law requires employers to submit copies of employe withholding exemption certificates to the department whenever they are required to provide such information to the Internal Revenue Service (IRS). The copies must be submitted to the department within 15 days after they are filed with the IRS.

For both federal and Wisconsin purposes, employers are required to submit copies of any employe's withholding exemption certificate if (1) the number of exemptions claimed is more than 10 or (2) the employe is claiming complete exemption from withholding and he or she earns more than $200 per week.

REMINDER: NONRESIDENT ENTERTAINERS REQUIRED TO FILE SURETY BOND OR CASH DEPOSIT

A "nonresident" entertainer who performs in Wisconsin for a contract price that exceeds $3,200 is required to file a surety bond or cash deposit with the Department of Revenue in an amount of 6% of his or her total contract price.

If the bond or deposit is not filed, the "employer" at the event is required to withhold 6% from the nonresident entertainer's payment. If the employer fails to withhold the required amount, the employer will be held liable for the amount that should have been withheld.

A "nonresident entertainer" is a nonresident person who furnishes amusement, entertainment, or public speaking services, or performs in one or more sporting events, and includes a foreign corporation (one not organized under the laws of Wisconsin) not regularly engaged in business in Wisconsin which derives income from any of these activities or from these services performed by a nonresident person.

An "employer" is any Wisconsin resident person or firm which contracts for the services of a nonresident entertainer. In the absence of such resident contracting person, the employer is the last resident person or firm to have receipt, custody, or control of the proceeds of the event. If there is neither a resident contracting person nor a resident with control of the proceeds, the employer is any nonresident person or firm who contracts for or has control of the proceeds of the event.

Amounts of cash deposited with the Department of Revenue with Form WT-10 (Nonresident Entertainer's Application & Receipt for Surety Bond or Cash Deposit) and amounts withheld by employers and reported on Form WT-11 (Nonresident Entertainer's Receipt for Withholding by Employer) may be claimed as a credit by the nonresident entertainer on his or her Wisconsin individual income tax return or on the corporation's franchise or income tax return for the year in which the appearance was made. Any amounts deposited or withheld that are in excess of the nonresident entertainer's Wisconsin tax liability per the return will be refunded.

Surety bonds filed with the Department of Revenue with Form WT-10 will be released upon request when the nonresident entertainer's tax liability for the year involved has been satisfied.

Additional information may be obtained by requesting Publication 508, "Wiscon-

sin Tax Requirements Relating to Nonresident Entertainers."

Copies of Publication 508, Form WT-10, Form WT-11, and the Nonresident Entertainer's Surety Bond may be obtained from the Wisconsin Department of Revenue, Shipping and Mailing Section, P. O. Box 8903, Madison, Wisconsin 53708.

Any questions about the requirements of this law may be directed to Karl Foss, Wisconsin Department of Revenue, P. O. Box 8906, Madison, Wisconsin 53708, telephone (608) 266-3645.

INFORMATION OR INQUIRIES?

Madison - Main Office
Area Code (608)

Beverage, Motor Fuel, Cigarette, Tobacco Products	266-6701
Corporation Franchise or Income	266-3645
Estimated Taxes	266-9940
Fiduciary, Inheritance, Gift	266-1231
Homestead Credit	266-8641
Individual Income	266-2486
Property Tax Deferral Loan	266-1983
Sales, Use, Withholding	266-2776
Audit of Returns: Corporation, Individual, Homestead, Sales	266-2772
Appeals	266-0185
Refunds	266-8100
Delinquent Taxes	266-7879
Copies of Returns: Homestead, Individual	266-2890
All Others	266-0678
Forms Request: Taxpayers	266-1961
Practitioners	267-2025

District Offices

Appleton	(414) 832-2727
Eau Claire	(715) 836-2811
Milwaukee	(414) 227-4000

WE ARE FREQUENTLY ASKED . . .

1. **Question:** If I received a wage statement (Form W-2) after I have filed my income tax return, what should I do?

   Answer: Obtain Wisconsin Form 1X from any department office and recompute your tax using the correct income you earned. Mail Form 1X to the address shown on the form.

2. **Question:** Can a person who is a full-year resident of Wisconsin file using Wisconsin Form 1 if the person's spouse is a nonresident or part-year resident?

   Answer: Yes, provided the person is filing as married filing separately. If the person and his or her spouse wish to file a joint Wisconsin return, they must use Form 1NPR.

3. **Question:** If my gross income is above the Wisconsin filing requirement, but because of subtraction modifications, my taxable income is below the filing requirement, must I file a Wisconsin income tax return?

   Answer: Yes, you are required to file a Wisconsin income tax return. The filing requirement is based on gross income before subtraction modifications.

4. **Question:** I am filing for a 4-month extension of time to file my federal income tax return. Does this extension apply to my Wisconsin return?

   Answer: Yes. The 4-month federal extension will apply to your Wisconsin return provided you attach a copy of the federal extension application to the Wisconsin return you file.

5. **Question:** How can I get my withholding back if I don't have a filing requirement?

   Answer: You must file a completed Wisconsin income tax return to obtain a refund, even if you are not required to file a Wisconsin tax return.

ACCOUNTANT SENTENCED FOR FAILURE TO FILE RETURNS

Income Taxes

A Madison accountant has been ordered to serve 3 years probation and 6 months in jail for criminal violations of Wisconsin state income tax laws. James L. Nicholson, 2666 Pennwall Circle, Madison, was sentenced in Dane County Circuit Court, Branch 4, after he pled no contest to 2 counts of failing to timely file state income tax returns for 1985 and 1987 and 2 counts of failure to deposit state income taxes withheld from his employes' wages during 1986. Judge Jack Aulik also sentenced Nicholson to provide 240 hours of community service. Under the conditions of probation, Nicholson must make restitution of all taxes, penalties and interest due in excess of $12,000.

Bernard A. Brennan, 539 East McKinley Street, Appleton, was sentenced in Outagamie County Circuit Court, Branch 5, after he was convicted on one count of failing to timely file a state individual income tax return. Judge Michael Gage sentenced Brennan to 9 months in jail, stayed execution of the sentence, and ordered Brennan to serve 2 years probation. Under the conditions of probation, Brennan must serve 60 days in jail, make restitution of state income taxes in excess of $4,000, and file his tax returns on time during the probationary period.

Melvin G. Flannery, 606 South Grandview Avenue, Crandon, Wisconsin, was sentenced in Dane County Circuit Court, Branch 6, Madison. Judge James Boll ordered Flannery to pay a $500 fine after he pled no contest to one count of failing to timely file a state income tax return for 1983.

Ronald J. White, 7426 Country Club Road, Oshkosh, Wisconsin, was sentenced in Winnebago County Circuit Court, Branch 3, Oshkosh. Judge Thomas S. Williams ordered White to serve 2 years probation after he pled no contest to 2 counts of

failing to timely file state income tax returns for 1985 and 1986. Under the conditions of probation, White must serve 4 weeks in the Winnebago County jail, pay fines totaling $1,500, and make restitution of all taxes, penalties, and interest due. He must also file all tax returns on time during the probationary period.

An Appleton woman has been ordered to serve time in jail for violations of the Wisconsin state tax laws. Marion E. Hoffman, 2729 South Greenview Street, Appleton, Wisconsin, was sentenced in Calumet County Circuit Court, Chilton, on one count of filing a false Wisconsin state income tax return. Judge Hugh F. Nelson withheld sentence and placed Hoffman on probation for 3 years. Under the conditions of probation, Hoffman must serve 4 months in jail, make restitution of state income taxes and homestead credit claims in excess of $2,400, and she will also be secondarily liable for restitution of homestead credit claims of 4 other defendants in related false refund cases.

Also charged with filing false homestead credit claims were Roger Fahrenkrug, Cheri Cross, and Thomas Cross, Appleton, and Cara Techlin, Little Chute. Techlin was sentenced to serve 2 years probation on July 17, Thomas Cross was sentenced to serve 2 years probation on April 11, Cheri Cross was sentenced to serve 2 years probation on June 19, and Roger Fahrenkrug was ordered to serve 3 years probation on June 12. Judge Nelson ordered each of them to make restitution for false homestead credit refunds as a condition of probation. Roger Fahrenkrug and Thomas Cross must also serve 15 days in jail.

Excise Taxes

On June 20, 1989, 420-422 Water Street, Inc., d/b/a "Harpo's Bar," Eau Claire, plead "no contest" to a charge of failing to maintain liquor invoices. Judge Thomas Barland fined the corporation $144 and dismissed a charge of purchasing liquor from other than a Wisconsin wholesale as part of a plea agreement.

Premium Beer Distributing Co., Inc., 560 Rolling Meadows Drive, North Fond du Lac, Wisconsin, plead "no contest" on April 10, 1989, to a charge of warehousing liquor without a permit. The corporation was fined $500 plus costs.

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 October 1, 1989. Part C lists new rules and amendments which were adopted in 1989. Part D lists emergency rules. ("A" means amendment, "NR" means new rule, "R" means repealed and "R&R" means repealed and recreated.)

A. Rules at Legislative Council Rules Clearinghouse

2.41 Separate accounting method-A
2.46 Apportionment of business income of interstate air carriers-R&R
2.47 Apportionment of net business income of interstate motor carriers of property-A
2.49 Apportionment of net business incomes of interstate finance companies-R&R
3.03 Dividends received, deductibility of-R&R
3.08 Retirement and profit-sharing payments by corporations-A
3.10 Salesmen's and officers' commissions, travel and entertainment expense of corporations-R
3.12 Losses on account of wash sales by corporations-R&R
3.37 Depletion of timber by corporations-A
3.38 Depletion allowance to incorporated mines and mills producing or finishing ores of lead, zinc, copper, or other metals except iron-A
3.47 Legal expenses and fines—corporations-R
3.54 Miscellaneous expenses not deductible—corporations-R&R
3.81 Offset of occupational taxes paid against normal franchise or income taxes-A
3.91 Petition for redetermination-A
3.92 Informal conference-A
3.93 Closing stipulations-A
3.94 Claims for refund-A
11.05 Government units-A
11.09 Medicines-A
11.10 Occasional sales-A
11.12 Farming, agriculture, horticulture and floriculture-A
11.16 Common or contract carriers-A
11.18 Dentists and their suppliers-A
11.19 Printed material exemptions-A
11.26 Other taxes in taxable gross receipts and sales price-A
11.32 "Gross receipts" and "sales price"-A
11.40 Exemption of machines and processing equipment-A
11.41 Exemption of property consumed or destroyed in manufacturing-A
11.51 Grocers' guidelist-A
11.57 Public utilities-A
11.61 Veterinarians and their suppliers-A
11.66 Communications and CATV services-A
11.67 Service enterprisesA
11.68 Construction contractors-A
11.84 Aircraft-A
11.85 Boats, vessels and barges-A

B. Rules at Revisor of Statutes Office for Publication of Hearing Notice

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
2.04 Information returns and wage statements-R&R
2.05 Information returns, forms 8 for corporations-R&R
2.06 Information returns required of partnerships and persons other than corporations-R
2.07 Income tax returns of liquidated or dissolved corporations-R

2.08 Returns of persons other than corporations-A
2.081 Indexed income tax rate schedule-R
2.085 Claim for refund on behalf of a deceased taxpayer-A
2.10 Copies of federal returns, statements, schedules, documents, etc., to be filed with Wisconsin returns-A
2.105 Notice by taxpayer of federal audit adjustments and amended returns-A
2.11 Credit for sales and use tax paid on fuel and electricity-A
2.12 Amended income and franchise tax returns-A
2.13 Moving expenses-A
2.15 Methods of accounting for corporations-A
2.17 Cash method of accounting for corporations-R
2.18 Accrual method of accounting for corporations-R
2.30 Property located outside Wisconsin—depreciation and sale-A
2.31 Taxation of personal service income of nonresident professional athletes-A
2.50 Apportionment of net business income of interstate public utilities-A
2.51 Rent received by corporations from Wisconsin real estate-A
2.69 Income from Wisconsin business-R
2.73 Involuntary conversion by corporations-A
2.74 Gain or loss on disposition of property by corporations; adjustment to basis-R
2.75 Recoveries by corporations-A
2.76 Refunds of taxes to corporations-A
2.80 Improvements of leased real estate, income to corporate lessor-A
2.81 Damages received by corporations-A
2.86 Income to corporations from cancellation of government contracts-A
2.89 Penalty for underpayment of estimated tax-R
2.945 Spousal individuial retirement contributions-R
2.955 Credit for income taxes paid to other states-A
2.96 Extension of time to file corporation franchise or income tax returns-A
2.98 Disaster area losses-A
3.085 Retirement plan distributions-A
3.096 Interest paid on money borrowed to purchase exempt government securities-A
3.24 Corporation taxes, miscellaneous-R
3.55 Donations and contributions—corporations-R
11.535 Operators of a swap meet, flea market, craft fair or similar event-NR
14.01 Administrative provisions-R&R
14.02 Qualification for credit-R&R
14.03 Household income-R&R
14.04 Property taxes accrued-R&R
14.05 Rent constituting property taxes accrued-R&R
14.06 Marriage, separation, or divorce during claim year-NR

C. Rules Adopted in 1989 (effective date is given in parentheses)

1.001 Definition-A (8/1/89)
2.14 Aggregate of personal exemptions-A (8/1/89)
2.16 Change in method of accounting for corporations-A (8/1/89)
2.19 Installment method of accounting for corporations-A (8/1/89)
2.20 Accounting for acceptance corporations, dealers in commercial paper, mortgage discount companies and small loan companies-A (8/1/89)
2.21 Accounting for incorporated contractors-A (8/1/89)
2.22 Accounting for incorporated dealers in securities-R&R (8/1/89)
2.24 Accounting for incorporated retail merchants-A (8/1/89)
2.25 Corporation accounting generally-A (8/1/89)
2.26 "Last in, first out" method of inventorying for corporations-A (8/1/89)
2.45 Apportionment in special cases-A (8/1/89)
2.50 Apportionment of net business income of interstate public utilities-A (8/1/89)
2.505 Apportionment of net business income of interstate professional sport clubs-A (8/1/89)
2.53 Stock dividends and stock rights received by corporations-A (8/1/89)
2.56 Insurance proceeds received by corporations-A (8/1/89)
2.57 Annuity payments received by corporations-A (8/1/89)
2.60 Dividends on stock sold "short" by corporations-A (8/1/89)
2.61 Building and loan dividends on installment shares received by corporations -R (8/1/89)
2.63 Dividends accrued on stock-A (8/1/89)
2.65 Interest received by corporations-A (8/1/89)
2.70 Gain or loss on capital assets of corporations; basis of determination-A (8/1/89)
2.72 Exchanges of property by corporations generally-A (8/1/89)
2.721 Exchanges of property held for productive use or investment by corporations-A (8/1/89)
2.83 Requirements for written elections as to recognition of gain in certain corporation liquidations-A (8/1/89)
2.88 Interest rates-A (8/1/89)
2.90 Withholding; wages-A (8/1/89)
2.91 Withholding; fiscal year taxpayers-A (8/1/89)
2.92 Withholding tax exemptions-A (8/1/89)
2.93 Withholding from wages of a deceased employe and from death benefit payments-A (8/1/89)
2.956 Historic structure and rehabilitation of nondepreciable historic property credits-NR (8/1/89)
3.01 Rents paid by corporations-A (8/1/89)
3.05 Profit-sharing distributions by corporations-A (8/1/89)
3.07 Bonuses and retroactive wage adjustments paid by corporation-A (8/1/89)
3.09 Exempt compensation of military personnel-A (8/1/89)
3.095 Income tax status of interest and dividends from municipal, state and federal obligations received by individuals and fiduciaries-A (9/28/89)

3.098 Railroad retirement supplemental annuities-A (8/1/89)
3.14 Losses from bad debts by corporations-A (8/1/89)
3.17 Corporation losses, miscellaneous-A (8/1/89)
3.35 Depletion, basis for allowance to corporations-A (8/1/89)
3.36 Depletion of timber by corporations-A (8/1/89)
3.43 Amortization of trademark or trade name expenditures-A (8/1/89)
3.44 Organization and financing expenses—corporations-A (8/1/89)
3.45 Bond premium, discount and expense—corporations-A (8/1/89)
3.48 Research or experimental expenditures-A (8/1/89)
3.52 Automobile expenses—corporations-R&R (8/1/89)
3.82 Evasion of tax through affiliated interests-A (8/1/89)
3.83 Domestic international sales corporations (DISCs)-A (8/1/89)
11.10 Occasional sales-A (5/1/89)

D. Emergency Rules

11.66 Communication and CATV services-A (effective 10/1/89)

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 the Commission's decision).

The following decisions are included:

Individual Income Taxes

Corporation Franchise or Income Taxes

Sales/Use Taxes

INDIVIDUAL INCOME TAXES

Nonresidents—personal service income. *John M. Dorsey vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, March 17, 1989). The only issue before this Commission is whether part of the $125,000 received by the taxpayer on July 10, 1984, at the time of the contract signing is taxable to the taxpayer, a nonresident of Wisconsin in 1984. In the event that there is a final determination that no portion of the $125,000 received by the taxpayer on July 10, 1984, is subject to Wisconsin income taxation, or that the amount subject to taxation is less than that assessed by the department, the itemized deductions allowed in the assessment notice will be subject to the adjustment for nonresident persons provided in sec. 71.02(2)(f), Wis. Stats.

John M. Dorsey, resided at all times during 1984 in the state of Connecticut.

On July 10, 1984, the taxpayer signed National Football League Player contracts with the Green Bay Packers for the 1984, 1985, and 1986 football seasons. Attached to and a part of the 1984 contract, was a rider providing for the additional payment of $125,000 in and for the year 1984. The taxpayer received the $125,000 at the time of signing the contract.

In filing his 1984 Wisconsin individual income tax return, the taxpayer claimed a Wisconsin subtraction from federal income of $150,000 for "Signing Bonus Green Bay Packers—Contract" and reported Wisconsin taxable income of zero.

Based on the taxpayer's 1984 W-2 form received from the Green Bay Packers, Inc., showing the taxpayer received total compensation of $152,457 from the Green Bay Packers, Inc., in 1984 and that $139,500 of such compensation was Wisconsin income, the department, on April 18, 1986, issued an assessment to the taxpayer taxing the income set forth of $139,500 less the taxpayer's IRA contribution of $2,000 and less prorated itemized deductions of $12,358, resulting in Wisconsin adjusted net taxable income of $125,142.

The $125,000 paid to the taxpayer was not a pure signing bonus requiring only his execution of the contract since in return for the bonus he was required not only to sign, but also perform a number of personal services. The taxpayer's bonus was an advance payment for the services which he agreed to render under the terms of the rider attached to his 1984 contract.

The Commission concluded that the bonus which the taxpayer received pursuant to the rider attached to his 1984 contract constituted income derived from the performance of personal services within the meaning and intent of secs. 71.01(1) and 71.07(1), Wis. Stats., and as such was properly taxable in Wisconsin to the extent that it represented compensation for those services which he rendered within Wisconsin.

The taxpayer has not appealed this decision.

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Foreign taxes paid. *Klaus Wacker vs. Wisconsin Department of Revenue* (Circuit Court of Milwaukee County, June 29, 1989). The issue is whether the taxpayer should be allowed to subtract from Wisconsin income his share of partnership trade taxes imposed by West Germany. A foreign tax credit had been allowed for federal tax purposes with respect to the trade taxes. See WTB 47 for a summary of the Commission's decision.

Understanding the weight to be given the determination of the Commission, the presumption that exists, and the burden placed upon Klaus Wacker, the Court found that the expenses incurred were business expenses of the subject partnership. This decision is dictated by the underlying reality that a different result produces unfair consequences to the taxpayer and an illogical application of the tax code. Because the intervening federal credit treats these expenses differently or dually does not alter their character as a business expense for purposes of the Wisconsin Revenue Code.

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

□

CORPORATION FRANCHISE OR INCOME TAXES

Manufacturer's sales tax credit—manufacturing defined. *Astra Plating, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 23, 1989). The issue is whether the taxpayer's automobile "bumper recycling" operation constitutes manufacturing. In fiscal years 1983 and 1984, the taxpayer claimed certain sales tax credits against its franchise tax liability. The department denied the credits on the grounds the taxpayer was not a manufacturer and, thus, did not qualify for the credits.

In general, the taxpayer's business could be described as a bumper recycling operation. The taxpayer takes scrap bumpers (worth $8-10 per ton) or, as they are known in the trade, "cores," reshapes them through a series of different operations, refinishes them, and sells them mainly to car dealers and independent body shops.

The taxpayer obtains the discarded cores from car dealers and auto body shops and stores them in its own storage area. When the taxpayer gets an order for a particular bumper, an employe removes the closest matching cores from the storage yard and brings them into the shop. For 90-95% of the orders, it's necessary to use two cores to produce the final product because part of one core is so badly damaged that it needs to be replaced. In such cases, both cores are measured to determine the location of cuts to be made. Both cores are then cut and the damaged parts either discarded or set aside. The remaining two pieces are welded.

After the welding is completed, the weld ridge is smoothed over with an electric grinder. Then the core is placed on a template, which matches manufacturer specifications, and is measured against the specifications. If necessary, the core is reshaped so as to match original equipment specifications. The taxpayer uses hydraulic presses to do the major reshaping. Some of the reshaping is done by means of manual hammering.

Next, the core is ground to remove scratches and other imperfections. As part of this process it is necessary to obtain a finish with a high luster; otherwise the untreated core would reflect internal imperfections because of the high mirror finish that the taxpayer ultimately puts on them. To remove the major imperfections, the taxpayer uses electric grinders applying a coarse grit abrasive. As an intermediate step, the taxpayer uses a semi-automatic polishing machine applying a finer grit abrasive to the core. Afterward, the core is put on a polishing lathe to obtain the proper pre-electroplating finish.

After the grinding and polishing are completed, the core undergoes the electroplating process—the final step resulting in the bright mirror finish. The electroplating adds new metal—between 1 and 2 mills of nickel. The bumper then is ready for sale at a price approximately 25-40% lower than what the original equipment manufacturer would charge.

Although 75-80% of the taxpayer's sales are to auto dealers and body shops, occasionally the taxpayer does work for individual consumers who are restoring their cars. With individual restoration work, the process is basically the same, except that sometimes the necessary core is not available. In such cases, the taxpayer actually splices a handmade piece of steel onto the core. Individual restoration work accounted for 1-2% of the taxpayer's sales. Another part of taxpayer's business is making customized bumpers for individual truck owners. This accounted for about 5-10% of the taxpayer's sales.

On the point of whether the taxpayer's process is popularly regarded as manufacturing, the taxpayer presented testimony to the effect that with the industry, the taxpayer's business is regarded as manufacturing. The taxpayer also testified that the U.S. Census Bureau classifies the taxpayer as a manufacturer, though the record is not clear on how the Census Bureau reached that determination. There was also testimony that the taxpayer is classified as an electroplater under the U.S. Government's standard industrial classification code 3471, a classification which falls under the general classification of manufacturing.

On the same point, the department presented contradictory expert testimony to the effect that the taxpayer's process is not popularly regarded as manufacturing. The expert based this conclusion on several points: the product being repaired to come back to original specifications; the product didn't have a different form, use, or name; and taxpayer's process was more like an automotive repair shop, a service industry, than manufacturing. He concluded the product is rebuilt, not manufactured. For the taxpayer's operation to qualify as manufacturing, the witness said, "The raw material would have to be in a much more amorphous form, be it plate steel or whatever." However, the witness did concede that in the 90-95% of the cases where welding is involved, the resulting constituted "two olds put together to make one new," and agreed "in a narrow sense" that the resulting article was new.

The Commission concluded that by the substantial weight of the evidence, the taxpayer's process is, in the legal sense, popularly regarded as manufacturing. The cores processed by the taxpayer have no significant intrinsic value to anyone other than the taxpayer. Consequently, the taxpayer's operations cannot be deemed to be repairs.

The department has petitioned the Commission for a rehearing. The petition for rehearing was granted.

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Business loss carryforward—mergers. *Appleton Papers, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, July 25, 1989). The only issues in this case are whether the taxpayer is entitled under sec. 71.043(3), Wis. Stats., to carry forward and apply against its 1982-84 Wisconsin corporate franchise tax liability, the excess 1981 manufacturer's sales and use tax credit generated in the business operations of one of its former wholly owned subsidiaries, subsequently merged into the taxpayer in 1982 along with 4 other corporations.

Appleton Papers, Inc. (new API) is a Delaware corporation and a successor in name to Germaine Monteil Cosmetiques Corporation (Germaine), a Delaware corporation. Pursuant to a statutory merger effective January 2, 1982, Germaine merged into itself under Delaware corporate law 5 of its wholly owned subsidiaries. Among the 5 subsidiaries merged with Germaine was Appleton Papers, Inc. (In this decision old API refers to Appleton Papers, Inc. as it existed prior to merger on January 2, 1982, in contradistinction to the taxpayer, new API.)

On its 1982-84 Wisconsin corporate franchise tax returns, the taxpayer claimed carryforwards of manufacturer's sales tax credits under sec. 71.043(3), Wis. Stats., generated in 1981 by old API's payment of Wisconsin sales and use taxes on fuel and electricity consumed in its Wisconsin paper manufacturing operation.

The department conceded that the 1981 manufacturer's sales tax credit was correctly computed by old API and that the 1982-84 credit carryforwards were timely claimed and properly computed by the taxpayer. The department disputed, however, the taxpayer's legal entitlement to the credit because of the 1982 merger.

After the merger in 1982, the taxpayer conducted the same Wisconsin paper manufacturing and sales operation as conducted by old API before the merger. The taxpayer also continued the pre-merger cosmetics business of Germaine. The taxpayer's franchise tax liability for 1982-84 was entirely derived from its Wisconsin paper manufacturing and sales operations. Cosmetics operations in Wisconsin, a minor venture at that, lost money in those years. There was a substantial continuity of key officers and employes between old API and the taxpayer. The merger in question was treated as a liquidation under sec. 332 of the Internal Revenue Code.

The Commission ruled that the excess 1981 manufacturer's sales and use tax credit on fuel and electricity consumed in manufacturing attributable to old API's paper manufacturing and sales operations in Wisconsin was available to the taxpayer under sec. 71.043(3), Wis. Stats., for years successive to 1981, including 1982-84, as an offset to its Wisconsin corporate franchise tax liability derived from the continued operation of said business, by reason of its status as successor by merger to old API.

The department has appealed this decision to the Circuit Court.

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Consolidated filing. *The Williams Companies, Inc., and Its Domestic Subsidiaries vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, June 14, 1989). The issue in this case is whether the Wisconsin Tax Appeals Commission should grant the Wisconsin Department of Revenue's motions to dismiss all or a part of taxpayer's two petitions for review, on the following grounds:

A. That taxpayer has filed claims for refund for the years 1984, 1985, and 1986 on the basis of combined or consolidated reporting of all of the income of The Williams Companies, Inc., and Its Domestic Subsidiaries (TWC, et al.) which is not permissible under Wisconsin law. Further, the taxpayer's application of the statutory apportionment formula in its claims for refund fails to include the income and factors of its unitary foreign subsidiaries and, in addition, causes the income of one of its subsidiaries, The Williams Pipeline Company (WPL), to be apportioned by an apportionment formula other than the special apportionment formula provided for under Wisconsin law for interstate pipeline companies.

B. That TWC, et al., may not claim a refund of taxes paid by one of its subsidiaries, WPL, for 1984, 1985, or 1986 since sec. 71.10(10)(gm), Wis. Stats., provides that "A refund payable on the basis of a separate return shall be issued to the person who filed the return," and WPL not TWC, et al., is the person who paid the tax and filed the return.

C. That the taxpayer's claim for refund for 1984 is barred under sec. 71.10(10)(d) and sec. 71.10(10)(e), Wis. Stats., by the field audit assessment against WPL which became final before the filing of the claim for refund.

During the years at issue, 1984, 1985, and 1986, The Williams Companies (TWC), the predecessor of The Williams Companies, Inc., was a Nevada corporation with its principal place of business in Tulsa, Oklahoma. TWC was the parent corporation of, and directly or indirectly owned, it's domestic subsidiaries.

For purposes of this motion, the department and the taxpayer agree that TWC and it's domestic subsidiaries constituted a unitary business engaged in the manufacture and sale of petroleum and agricultural products, real estate development, and various other business activities. WPL was a wholly owned subsidiary of TWC included within the TWC, et al., group, and was engaged in the interstate transportation of oil, gas, and other solutions by pipeline. Its principal place of business

was Tulsa, Oklahoma.

WPL filed separate Wisconsin franchise tax returns for the years 1984 to 1986 (all of the TWC subsidiaries that operated in, or were qualified to do business in Wisconsin, filed separate Wisconsin tax returns). On each return, WPL computed its income attributable to Wisconsin by using the special apportionment formula for interstate pipeline companies provided for in sec. Tax 2.48, Wis. Adm. Code.

The department assessed WPL for additional franchise taxes and interest for the years 1981 through 1984; none of the additional tax was based upon deconsolidating WPL's return or recomputing WPL's income on a combined reporting basis. The assessment was paid by WPL.

TWC, et al., filed a claim for refund of franchise taxes paid by WPL for the years 1984 and 1985. The claim for refund was in the form of an amended Wisconsin franchise tax return designating TWC, et al., as the taxpayer. TWC, et al., in its claim for refund computed the income of the group of corporations covered by the claim using the standard 3 factor apportionment formula provided for in sec. 71.07(2), Wis. Stats. The denominators of the factors were for the total company "consolidated." The Wisconsin return had attached The Williams Companies' consolidated federal return. The department denied the claim for refund for the reasons that Wisconsin does not permit the filing of consolidated returns and that the year 1984 had been closed to refunds by field audit assessment.

TWC, et al., subsequently filed a claim for refund for the year 1986 for franchise taxes paid by WPL for its taxable year 1986. The claim for refund was in the form of a Wisconsin franchise tax return designating TWC, et al., as the taxpayer. TWC, et al., in its claim for refund computed the income of the group of corporations covered by the claim using the standard 3 factor apportionment formula. The denominators of the factors were for the total company "consolidated." The Wisconsin return had attached The Williams Companies and Subsidiaries' consolidated federal return. The department denied the claim for refund for the year 1986 for the reason that Wisconsin does not permit the filing of consolidated returns.

The Commission found that in *Interstate Finance Corp. v. Dept. of Taxation*, 28 Wis. 2d 262 (1965), the Wisconsin Supreme Court clearly rejected the use of consolidated returns by a unitary business. Since *Interstate*, the Wisconsin legislature has not passed legislation allowing for the filing of consolidated returns by unitary businesses. In the absence of any such statutory changes, the Commission ruled that the taxpayer is not entitled to file claims for refund which are based upon consolidated returns prepared using combined reporting and, therefore, granted the Department's motion to dismiss taxpayer's petition for review.

The taxpayer has not appealed this decision.

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SALES/USE TAXES

When and where sale takes place. *Marathon Electric Manufacturing Corp. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, February 27, 1989). On March 17, 1988, the Wisconsin Tax Appeals Commission issued a decision and order that was subsequently appealed by both parties to the Dane County Circuit Court. See WTB 58 for a summary of the Commission's decision. On October 6, 1988, the case was remanded to the Commission for the specific purpose of making a finding of fact as to "whether the aircraft was located in Wisconsin in 1980."

After reviewing the entire record the Commission, in compliance with the Court's remand, made the following additional finding of fact:

The aircraft in question was delivered to the taxpayer in December of 1980 in Kansas, and first arrived in Wisconsin in January of 1981. It was not located in Wisconsin in 1980.

In all other respects, the Commission's original decision and order of March 17, 1988 was affirmed.

The department has not appealed this decision.

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Manufacturing defined and scope of. *Department of Revenue v. Pavelski Enterprises, Inc.* (Court of Appeals, District IV, April 20, 1989). The Wisconsin Department of Revenue appeals from a judgment affirming a Wisconsin Tax Appeals Commission decision that Pavelski Enterprises, Inc.'s Lor-Al Air-Flow Dry Sprayer machines are exempt from sales and use taxes under the manufacturing exemption, sec. 77.51(27), Wis. Stats.

Pavelski, a retail fertilizer and farm supply operation, purchased two Lor-Al Air-Flow Dry Sprayers in 1981 and 1983 for $84,159.37 and $90,650, respectively. Pavelski did not pay a sales or use tax at the time of purchase.

Pavelski analyzes a farmer's soil, then mixes ingredients to form agriculture grade fertilizer. The granular ingredients are physically mixed together in a machine with either an auger blender or a rotary drum blender. The liquid ingredients are sprayed on in a process called impregnation. The finished product would be given a specific analysis as a name.

After the fertilizer leaves the plant, it is conveyed to a delivery truck or unit. At this point, the mix segregates, with larger particles going to the outside and small particles staying in the center. The delivery truck takes the fertilizer to the farmer's field and places it in the Lor-Al machines, which have been transported there previously. At this point, further segregation occurs. The Lor-Al machine remixes the fertilizer with a horizontal and vertical auger configuration similar to the machine used at the plant. This returns the fertilizer to the analysis it had when it left the plant. No additional ingredients are added. It is then spread on the field through a pneumatic air process. A customer could pur-

chase fertilizer directly from the plant and apply it without using the Lor-Al machine.

Eldon Roesler, the executive secretary of the Wisconsin Feed, Seed and Farm Supply Association for 35 years, testified that the mixing which is done by the Lor-Al machine is regarded as manufacturing within his industry. Eldon Roesler testified that one must look at the Lor-Al mixing process as an extension of the manufacturing process since, if Pavelski recommends a certain blend of fertilizer, it has to produce that blend and distribute it correctly or it will be subjected to complaints and lawsuits by the farmer.

The Court concluded that the Commission's finding that the two steps are part of a continuous process is supported by this evidence. Although other evidence suggests that the second step is separate, it is not the Court's function to weigh the evidence. The department concedes that the mixing which occurs at the plant is manufacturing. Since the finding that the two steps are inseparable is supported by substantial evidence, the determination that the Lor-Al machines are entitled to the manufacturing exemption has a rational basis.

The department appealed this decision to the Wisconsin Supreme Court. The Wisconsin Supreme Court denied the department's petition for review.

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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

Farmland Preservation Credit

Corporation Franchise or Income Taxes

Sales/Use Taxes

INDIVIDUAL INCOME TAXES

1. Limitations on Farm Losses

Statute: Section 71.05(6)(a)10, Wis. Stats. (1987-88)

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

Background: A new add modification, sec. 71.05(1)(a)26, Wis. Stats., was created by 1985 Wisconsin Act 29, effective for taxable year 1986. That section was renumbered 71.05(6)(a)10 by 1987 Wisconsin Act 312, effective January 1, 1989. The modification limits the amount of combined net losses from farming businesses, exclusive of net gains and net profits, which may be claimed on a Wisconsin individual income tax return when nonfarm income exceeds prescribed levels. The limitations are explained in a Tax Release, WTB #51, page 9.

Facts and Question: Taxpayer F is a farmer who owns an interest in three related farms and materially participates in their operation, for the purpose of making a profit. Two of the farms, A and B, are organized as tax-option (S) corporations, while the third farm, C, is a farm partnership. Taxpayer F is the sole shareholder of farm A. In 1987, farms B and C operated at a profit while farm A sustained a net loss. Taxpayer F received wages from farm A. If these wages are nonfarm income, the farm loss limitations will apply for 1987. Are the wages which F received from farm A in 1987 considered to be nonfarm income for purposes of applying the farm loss limitations in sec. 71.05(6)(a)10, Wis. Stats. (1987-88)?

Answer: No. The wages from farm A are considered farm income, rather than nonfarm income. F is operating the farm for a profit as the sole shareholder. Wages received by the owner of a farm for participating in its operation can be distinguished from wages received by a farm employe, which would be considered nonfarm income. Since F is the sole shareholder and operates farm A, F's wages from farm A are farm-related income.

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2. Manufacturer's Sales Tax Credit Allowable to Shareholders of Tax-Option (S) Corporations

Statutes: Sections 71.26(2)(a), 71.28(3), 71.34(1)(e), and 71.47(2b), Wis. Stats. (1987-88), and sec. 71.04(3), Wis. Stats. (1985-86)

Note: This Tax Release supersedes the Tax Release with the same title which appeared in WTB 50. The questions are arranged in 3 sections. The years to which each section applies are indicated at the beginning of that section. The third section has been included as additional background information and does not extend the statute of limitations for years which are otherwise closed.

Background: Corporations may claim a credit equal to the sales and use tax under ch. 77, Wis. Stats., paid on fuel and electricity consumed in manufacturing tangible personal property in Wisconsin (sec. 71.28(3)(b), Wis. Stats. (1987-88)). If the credit computed is not entirely offset against Wisconsin franchise or income taxes otherwise due, the unused balance may be carried forward for up to 15 taxable years (sec. 71.28(3)(c), Wis. Stats. (1987-88)).

In *Wisconsin Department of Revenue v. Edwin F. Gordon*, 127 Wis. 2d 71 (1985), the Court of Appeals held that "the portion of Gordon's personal income tax that is measured by the net income of the tax-option corporation can be reduced by an amount equal to the corporation's tax credit under ch. 77, Wis. Stats." However, beginning with credits computed for the 1987 taxable year, secs. 71.07(10)(a), 71.28(3)(d), and 71.365(3)(b), Wis. Stats. (1987-88), provide that the shareholders of a tax-option (S) corporation may not claim the credit attributable to the corporation. Shareholders may continue to carry forward for up to 15 years unused manufacturer's sales tax credits generated in 1986 and prior taxable years.

For 1986 and prior taxable years, sec. 71.04(3), Wis. Stats. (1985-86), denied a deduction for sales and use taxes paid on fuel and electricity used in manufacturing where those taxes could be used in computing a manufacturer's sales tax credit.

Beginning with credits computed for taxable year 1987, the amount of credit claimed by a tax-option (S) corporation must be added to that corporation's net income pursuant to sec. 71.34(1)(e), Wis. Stats. (1987-88).

I. Computation of Amount of Credit or Credit Carryforward That May Be Claimed (This section applies for taxable year 1987 and thereafter with respect to unused credits carried forward from 1986 and prior taxable years. In addition, this section applies for 1986 and prior taxable years with respect to credits computed in or carried to those years.)

Facts and Question 1: A shareholder of a tax-option (S) corporation receives a pro rata share of the net income or loss of the corporation. In addition, the shareholder receives payments from the corporation such as salary for services performed, interest on loans to the corporation, taxable dividends paid by the corporation, and rents and royalties from assets leased to the corporation. Which of these amounts are included for purposes of determining the shareholder's "personal income tax that is measured by the net income of the tax-option corporation?"

Answer 1: The shareholder's share of the net income from the tax-option (S) corporation for purposes of computing the allowable manufacturer's sales tax credit is limited to the shareholder's pro rata share of the corporation's net income which is taxable by Wisconsin. For 1987 and thereafter, this is the net amount of the tax-option items of income, loss, and deduction passed through to the shareholder on Wisconsin Schedule 5K-1 to the extent that those items are subject to Wisconsin income tax. For 1986 and prior taxable years, this was the shareholder's pro rata share of the net income before the tax-option (S) corporation deduction that the corporation reported on its Wisconsin franchise or income tax return, Form 4. (For 1986, this was the shareholder's pro rata share of the amount on Wisconsin Form 4, line 25.)

Salary for services performed, interest on loans made to the corporation, taxable dividends paid by the corporation, and rents and royalties from assets leased to the corporation are not included in the corporation's net income. Therefore, the shareholder's personal income tax on these items cannot be offset by the manufacturer's sales tax credit.

Example A: In 1988, a shareholder received the following items from a tax-option (S) corporation:

Salary	$ 10,000
Interest on loan to the corporation	500
Pro rata share of corporation's interest income	100
Pro rata share of corporation's capital gain	10,000
Pro rata share of corporation's ordinary loss	(5,000)

The shareholder's share of the tax-option (S) corporation's net income or loss is a $900 loss, which is computed as follows:

Pro rata share of corporation's interest income	$100
Pro rata share of corporation's capital gain to extent taxable ($10,000 x 40% taxable)	4,000
Pro rata share of corporation's ordinary loss	(5,000)
Net income (loss) from tax-option (S) corporation	$ (900)

Example B: In 1986, a shareholder received the following income from a tax-option (S) corporation:

Salary	$30,000
Interest on loan to the corporation	1,000
Taxable dividend of pre-1979 earnings	3,000
Rent from assets leased to the corporation (after deducting rental expenses, the shareholder incurred a $2,500 loss)	5,000
Pro rata share of tax-option corporation net income (based on 1986 Wisconsin Form 4, line 25)	15,000

The shareholder's share of the tax-option (S) corporation's net income that may be used to compute the allowable manufacturer's sales tax credit is $15,000, which is her pro rata share of tax-option (S) corporation net income from 1986 Form 4, line 25.

Example C: In 1986, a shareholder received the following amounts from a tax-option (S) corporation:

Royalties on assets leased to the corporation	$50,000
Pro rata share of tax-option (S) corporation net loss (based on 1986 Wisconsin Form 4, line 25)	(40,000)

The shareholder's share of the tax-option (S) corporation's net income or loss is a $40,000 loss. Therefore, the shareholder cannot claim a manufacturer's sales tax credit in 1986.

Facts and Question 2: A taxpayer is a shareholder of a tax-option (S) corporation which has generated net income. How is the shareholder's personal income tax measured by the tax-option (S) corporation's net income computed?

Answer 2: One method for computing a shareholder's personal income tax measured by the tax-option (S) corporation's net income is by using the following formula:

$$\frac{\text{Shareholder's share of tax-option (S) corporation Wisconsin net income}}{\text{Shareholder's total Wisconsin income}} \times \text{Shareholder's net tax liability}$$

The shareholder's net tax liability is the gross income tax minus any credits, including credit for taxes paid to other states. It does not include IRA penalties or the Endangered Resources Donation.

Example D: In 1986, a shareholder's pro rata share of a tax-option (S) corporation's net income was $5,000 and his share of the corporation's manufacturer's sales tax credit was $250. The shareholder had total Wisconsin income of $30,000 and a net tax liability of $1,800. He can claim $250 of manufacturer's sales tax credit in 1986, which is the lesser of the manufacturer's sales tax credit available or the limitation computed as follows:

$$\frac{\text{\$5,000 tax-option (S) corporation net income}}{\text{\$30,000 total Wisconsin income}} \times \text{\$1,800 net income} = \text{\$300 personal income tax measured by tax-option (S) corporation net income}$$

Another method of determining the shareholder's personal income tax measured by the tax-option (S) corporation's net income is to subtract from the shareholder's net tax liability the amount that would be that person's net tax if all of the tax-option items were excluded.

Example E: In 1987, a tax-option (S) corporation passed through the following items to its sole shareholder: interest income of $300, longterm capital gain income of $15,000, and ordinary loss of $2,000. In addition to the tax-option items, the shareholder earned $20,000 of wages. The shareholder's total Wisconsin income was $24,300 and her net tax liability was $1,255. The shareholder had carried forward $500 of unused manufacturer's sales tax credit from 1986. To find out how much of the credit she can claim in 1987, she recomputed her Wisconsin income and net tax by excluding the tax-option items. Her total Wisconsin income would be $20,000 and her net tax would be $922. The $333 difference between her actual net tax of $1,255 and her recomputed net tax of $922 is her personal income tax measured by tax-option (S) corporation net income. She may claim $333 of the $500 of manufacturer's sales tax credit carryforward for 1987.

Facts and Question 3: A shareholder of a tax-option corporation which incurs a net loss for the taxable year is subject to the Wisconsin minimum tax as a result of having tax preference items from the corporation. May the minimum tax be offset by the shareholder's share of the manufacturer's sales tax credit?

Answer 3: No. The shareholder may not claim the manufacturer's sales tax credit against the minimum tax since the minimum tax is not measured by the net income of the tax-option (S) corporation. In addition, sec. 71.28(3)(b), Wis. Stats. (1987-88), provides that the credit may be offset only against tax imposed under sec. 71.23(1) or (2), Wis. Stats. (1987-88), formerly numbered sec. 71.01(1) or (2). Since the minimum tax is imposed under sec. 71.08(1), Wis. Stats. (1987-88), formerly numbered sec. 71.60, the minimum tax cannot be reduced by the manufacturer's sales tax credit.

Example F: In 1985, a shareholder's pro rata share of a tax-option (S) corporation's net loss was $400,000. Because of this loss, the shareholder owed no Wisconsin income tax for 1985. However, he was subject to Wisconsin minimum tax based on the following tax preference items: $14,000 of accelerated depreciation passed through from the tax-option (S) corporation and $30,000 of adjusted itemized deductions. The shareholder cannot offset his manufacturer's sales tax credit against his minimum tax due.

Facts and Question 4: If a taxpayer is a shareholder in more than one tax-option (S) corporation during the taxable year, how does the taxpayer compute the amount of manufacturer's sales tax credit that may be claimed for that year?

Answer 4: The amount of manufacturer's sales tax credit that may be claimed from each tax-option (S) corporation must be determined separately, based on the shareholder's personal income tax that is measured by the net income of that corporation. The shareholder cannot offset a manufacturer's sales tax credit from a tax-option (S) corporation which incurs a net loss against personal income tax measured by the shareholder's share of net income from another tax-option (S) corporation.

Example G: A taxpayer is a shareholder in two tax-option (S) corporations. In 1986, she received from Corporation P net income of $15,000 and a manufacturer's sales tax credit of $250. From Corporation M she received a net loss of $20,000 and manufacturer's sales tax credit of $500. The taxpayer's personal income tax measured by her share of Corporation P's net income

is $900, which is computed as follows:

$15,000 net income from Corp. P / $40,000 total Wisconsin income	X	$2,400 net tax liability	=	$900 personal income tax measured by Corp. P's net income

Therefore, the taxpayer may claim the $250 of Corporation P's manufacturer's sales tax credit. She cannot claim any portion of Corporation M's manufacturer's sales tax credit on her 1986 individual income tax return. Since Corporation M incurred a net loss in 1986, no part of her net tax liability is measured by net income of Corporation M.

Example H: A taxpayer is a shareholder in two tax-option (S) corporations. In 1986, he received from Corporation L a net loss of $20,000 and a manufacturer's sales tax credit of $200. From Corporation G he received net income of $50,000 and a manufacturer's sales tax credit of $600. The taxpayer cannot claim any portion of the $200 of credit from Corporation L since Corporation L incurred a net loss in 1986. The taxpayer may claim the $600 of Corporation G's credit on his 1986 individual income tax return since it does not exceed his personal income tax measured by his share of Corporation G's net income, which is computed as follows:

$50,000 net income from Corp. G / $35,000 total Wisconsin income	X	$1,700 net tax liability	=	$1,700 personal income tax measured by Corp. G's net income

II. Determination of Who May Claim a Credit or Credit Carryforward (This section applies with respect to credits computed in 1986 and prior taxable years.)

Facts and Question 5: A tax-option (S) corporation incurred net losses in 1985 and 1986. As a result, its shareholders would not be able claim their pro rata share of the corporation's manufacturer's sales tax credit available for those years. Since the shareholders did not receive a tax benefit from the credits, may the corporation in computing its net loss for 1985 and 1986 claim a deduction for the sales and use taxes paid on fuel and electricity used in manufacturing?

Answer 5: No. In computing its net loss, the corporation cannot deduct the sales and use taxes paid on the fuel and electricity which would be used to compute the manufacturer's sales tax credit. Although for taxable year 1987 and thereafter manufacturer's sales tax credits do not flow through to the shareholders, the shareholders are still able to carry forward for up to 15 years the unused credits from 1986 and prior taxable years. Alternatively, the corporation may claim the unused credits within the 15-year carryforward period against its franchise tax measured by U.S. government bond interest or, if it revokes its tax-option (S) status, against its franchise or income tax.

Facts and Question 6: A corporation which was a regular (C) corporation elects to be a tax-option (S) corporation. May this tax-option (S) corporation pass through to its shareholders unused manufacturer's sales tax credits from years in which it had been a regular (C) corporation?

Answer 6: If the corporation elected tax-option (S) corporation status to be effective for its 1986 taxable year or a prior taxable year, the corporation may pass through to its shareholders unused manufacturer's sales tax credits from years when it was taxed as a C corporation. If the corporation elected tax-option (S) corporation status effective for its 1987 taxable year or thereafter, the corporation cannot pass through unused credits to its shareholders.

Example I: A corporation was a regular (C) corporation for the 1983 through 1985 taxable years. In each of these years, the corporation incurred a loss. At the beginning of its 1986 taxable year, the corporation had $2,000 of unused manufacturer's sales tax credits from its 1983 through 1985 taxable years. The corporation elected tax-option (S) status effective for its 1986 taxable year. For 1986, the corporation had net income of $50,000 and a manufacturer's sales tax credit of $750. The corporation may pass through to its shareholders the $2,000 of unused manufacturer's sales tax credits from 1983 through 1985 in addition to the $750 credit from its 1986 taxable year.

Example J: A corporation which had been a regular (C) corporation for 1980 through 1986 elected tax-option (S) corporation status effective for its 1987 taxable year. The corporation had unused manufacturer's sales tax credits available from its 1985 and 1986 taxable years. The corporation cannot pass through these unused credits to its shareholders.

Facts and Question 7: For taxable year 1986 or a prior taxable year, a tax-option (S) corporation computed its allowable manufacturer's sales tax credit. May the corporation elect not to pass through the credit to its shareholders and, instead, use the credit itself in a year when the corporation returns to C corporation status?

Answer 7: Yes. For 1986 and prior taxable years, a tax-option (S) corporation may elect whether or not to pass the manufacturer's sales tax credit through to its shareholders. If the credits that were passed through are not completely used by the shareholders, the unused portion may be claimed by the corporation in a year when the corporation returns to C corporation status. For taxable year 1987 and thereafter, unused credits may also be used by the corporation to offset its franchise tax measured by U.S. government bond interest.

Example K: A tax-option (S) corporation incurred losses for 1980 through 1986 which were passed through to the shareholders. Although the corporation had a manufacturer's sales tax credit available for each of these years, the shareholders didn't receive a benefit from these credits. If the corporation revokes its subchapter S election effective for the 1987 taxable year, the corpo-

ration may carry forward the credits from 1980 through 1986 and claim them on its 1987 corporation franchise or income tax return.

Example L: A tax-option (S) corporation had income for 1986 which it passed through to the shareholders. The manufacturer's sales tax credit available for 1986 exceeded the shareholders' individual Wisconsin income tax liabilities on the tax-option (S) corporation income. If the corporation revokes its subchapter S election effective for the 1987 taxable year, the corporation may carry forward the unused portion of the 1986 credit and claim it on the corporation's 1987 franchise or income tax return.

Example M: The stock of a Wisconsin tax-option (S) corporation is held by nonresident shareholders, none of whom file Wisconsin income tax returns because their income is below the filing requirement. If the corporation revokes its subchapter S election, the corporation may claim the unused manufacturer's sales tax credits.

III. Computation of Credit Carryforwards From Taxable Years That Were Closed at the Time the *Gordon* Decision Was Issued (This section explains the treatment of credits computed for taxable years that were closed by the statute of limitations prior to October 22, 1985. It does not extend the statute of limitations for any closed years.)

Facts and Question 8: A manufacturer's sales tax credit computed in 1980 which could have been used in that year was not claimed because of the department's instructions that this credit did not pass through from the tax-option (S) corporation to its shareholders. At the time that the *Gordon* decision was issued, the year was closed to adjustments. May this unused credit be carried forward to 1981 and subsequent taxable years?

Answer 8: Yes. A credit computed in 1980 which could have been used in that year but which was not claimed may be carried forward to 1981 and subsequent taxable years. However, if the tax-option (S) corporation had claimed a deduction for sales and use taxes paid on fuel and electricity used in manufacturing in computing its net income or net loss for 1980, the amount of manufacturer's sales tax credit carried forward must be reduced by the tax benefit received by the shareholders from claiming the sales tax deduction.

Example N: A shareholder's share of tax-option (S) corporation net income for 1980 was $20,500. The corporation did not claim a deduction for sales and use taxes paid on fuel and electricity used in manufacturing. Her personal income tax measured by tax-option (S) corporation net income was $1,400. Her share of the corporation's manufacturer's sales tax credit computed in 1980 was $2,500. She followed the department's instructions and did not claim any portion of this credit on her 1980 individual income tax return. The shareholder may carry forward to 1981 and subsequent years the entire $2,500 credit because no part of the credit was used in 1980 and she did not receive a tax benefit for a sales and use tax deduction.

Example O: A shareholder's share of tax-option (S) corporation net income for 1980 was $20,000. In computing its net income, the corporation deducted $500 of sales and use taxes paid on fuel and electricity used in manufacturing. His share of the corporation's manufacturer's sales tax credit computed in 1980 was $500. He did not claim any portion of this credit on his 1980 individual income tax return. His net tax liability for 1980 was $2,038. If the corporation had not deducted sales and use taxes paid on fuel and electricity in computing its net income, his net income would have increased by $500 and his net tax liability would have been $2,085. Thus, he received a tax benefit of $47 ($2,085 - $2,038) for the sales and use tax deduction. The shareholder may carry forward to 1981 and subsequent years a manufacturer's sales tax credit of $453 ($500 credit - $47 tax benefit for sales and use tax deduction).

Facts and Question 9: In 1980, a tax-option (S) corporation computed a net loss, which included a deduction for sales and use taxes paid on fuel and electricity in lieu of a manufacturer's sales tax credit. When the *Gordon* decision was issued, 1980 was closed to adjustments. In addition, no part of a manufacturer's sales tax credit computed for 1980 could have been claimed in that year since the corporation had incurred a net loss. May the corporation carry forward to 1981 and subsequent taxable years its unused manufacturer's sales tax credit computed for 1980?

Answer 9: The unused credit computed for 1980 may be carried forward to 1981 and subsequent years, but it must be reduced by the tax benefit received by the shareholders from claiming the sales and use tax deduction.

Example P: A shareholder's share of tax-option (S) corporation net loss for 1980 was $5,000, which included a $500 deduction for sales and use taxes paid on fuel and electricity used in manufacturing. His share of the manufacturer's sales tax credit computed for 1980 was $500. He did not claim any portion of this credit on his 1980 individual income tax return. His net tax liability for 1980 was $15. If the corporation's net loss had not included a deduction for sales taxes paid on fuel and electricity, his net tax liability would have been $32. Thus, he received a tax benefit of $17 ($32 - $15). The shareholder may carry forward to 1981 and subsequent years a manufacturer's sales tax credit of $483 ($500 credit - $17 tax benefit for sales and use tax deduction).

Example Q: A shareholder's share of tax-option (S) corporation net loss for 1980 was $5,000, which included a $500 deduction for sales and use taxes paid on fuel and electricity used in manufacturing. His share of the corporation's manufacturer's sales tax credit computed for 1980 was $500. He did not claim any portion of this credit on his 1980 individual income tax return. He had no other income or loss for 1980; therefore, he carried the $5,000 loss over to 1981. On his 1981 return, he computed a net tax liability of $664. If the corporation's net loss for 1980 had not included a deduction for sales and use taxes paid on fuel and electricity, his share of the corporation's net loss would have been only $4,500 and his net tax liability for 1981 would have been $708. Thus, he received a tax benefit of $44 ($708 - $664) for the sales and use

tax deduction. The shareholder may carry forward to 1981 and subsequent years a manufacturer's sales tax credit of $456 ($500 credit - $44 tax benefit for sales and use tax deduction).

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3. Taxation of Wages Earned by Indians Living on a Reservation

Statutes: Section 71.02, Wis. Stats. (1987-88)

Background: Wages earned by Indians who live and work on their own tribal reservations are exempt from Wisconsin income tax. "Indians" means all persons of Indian descent who are enrolled members of any federally recognized tribe.

Facts and Question: An Indian lives on the reservation of a federally recognized Indian tribe of which he is an enrolled member. The Indian is required by his employer to work three days a week on different reservations. Each week he works one day on his own tribal reservation and two days on reservations of tribes of which he is not an enrolled member. For the remaining two days a week he works at a office which is not located on any reservation.

Are the wages earned by this Indian exempt from Wisconsin income tax?

Answer: The exemption for an Indian living on the reservation is limited to the amount earned on the reservation of the federally recognized Indian tribe of which he or she is an enrolled member. In this case the Indian earns 20% of his wages on his tribal reservation. Therefore, 20% of his wages are exempt from Wisconsin income tax.

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FARMLAND PRESERVATION CREDIT

1. Tax Payment Requirement for "Prior Law" Filers

Statutes: Sections 71.59(1)(b) and 71.60(1)(b), Wis. Stats. (1987-88)

Background: Section 71.59(1)(b) of the Wisconsin Statutes was amended in 1988 to require that a farmland preservation credit claimant's property taxes for the preceding year on the property for which the claim is made must be paid in order to qualify for the credit. This eligibility requirement became effective with claims filed for taxable year 1988. Section 71.60(1)(b), Wis. Stats. (1987-88), provides that the credit may be calculated under the farmland preservation credit law either as it exists at the end of the year for which the claim is filed or as it existed on the date the farmland became subject to a farmland preservation agreement or transition area agreement.

Facts and Question: John Farmer, a calendar year taxpayer, has a farmland preservation agreement executed in December 1986. He wishes to file a 1988 Wisconsin farmland preservation credit claim. However, he has not paid the 1987 property taxes for the farmland on which the claim is to be based. Is Mr. Farmer precluded from filing a claim because of sec. 71.59(1)(b), Wis. Stats. (1987-88), as long as the 1987 property taxes remain unpaid?

Answer: No. Section 71.60(1)(b), Wis. Stat. (1987-88), provides in part:

The credit for any claimant shall be the greater of either the credit as calculated under this subchapter as it exists at the end of the year for which the claim is filed or as it existed on the date on which the farmland became subject to a current agreement under subch. II or III of ch. 91, using for such calculations household income and property taxes accrued of the year for which the claim is filed.

"This subchapter" refers to subch. IX of ch. 71, which is the farmland preservation credit law. Subchapter II of ch. 91 provides for farmland preservation agreements and transition area agreements.

The taxpayer may compute a farmland preservation credit based on the law either as it existed at the end of 1988 or as it existed in December 1986. Since the taxes are not paid, he is ineligible under 1988 law, but he may compute a credit based on 1986 law, including eligibility requirements, household income, property taxes accrued, and credit computation. Since the payment of the prior year's taxes was not a requirement under 1986 law, Mr. Farmer's nonpayment of his 1987 property taxes does not preclude him from filing a claim using the law for 1986.

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CORPORATION FRANCHISE OR INCOME TAXES

1. Sales Factor—Throw Back of Sales From States in Which a Combined or Consolidated Return Is Filed

Statutes: Sections 71.25(9) and 71.26(3)(x), Wis. Stats. (1987-88)

Wis. Admin. Code: Section Tax 2.39, January 1978 Register

Background: Section 71.25(9), Wis. Stats. (1987-88), provides that the numerator of the Wisconsin sales factor includes 50% of the sales of tangible personal property shipped from a location in Wisconsin to a location in a state in which the taxpayer is not within the jurisdiction of the destination state for income tax purposes.

In Wisconsin, each corporate entity is required to file a separate Wisconsin return and compute its Wisconsin net income on a separate entity basis. Combined or consolidated returns are not allowed. Certain other states may require or allow the filing of combined or consolidated returns.

Question: Are sales of tangible personal property, shipped by a taxpayer to a state in which the taxpayer's net income is included in a combined return of a unitary group of corporations filed with the destination state, required to be included in the numerator (thrown back to Wisconsin) when computing the Wisconsin sales factor?

Answer: If the activities of the taxpayer, on a separate entity basis, in the destination state do not subject the taxpayer to the jurisdiction of that state for income tax purposes, the sales should be thrown back (at 50%) to Wisconsin. If the activities of the taxpayer, on a separate entity basis, in the destination state are sufficient to subject the taxpayer to the jurisdiction of that state for income tax purposes, the sales should not be thrown back to Wisconsin.

Example: Corporation A, headquartered in Minnesota, is the parent of a unitary group of corporations. Subsidiary B, headquartered in Illinois, files an Illinois return and reports the net income of the entire group on a combined basis. Subsidiary C, headquartered in Wisconsin, makes some sales into Illinois and its income is included in the combined return filed in Illinois by Subsidiary B. Subsidiary C has no activity in Illinois other than the sales shipped from Wisconsin and is not subject to the jurisdiction of Illinois for income tax purposes. Therefore, the sales made by Subsidiary C into Illinois should be thrown back to Wisconsin for purposes of the Wisconsin sales factor of Subsidiary C.

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SALES/USE TAXES

1. Appraisals of Tangible Personal Property

Statutes: Section 77.52(2)(a), Wis. Stats. (1987-88)

Question: Company ABC is in the business of appraising jewelry, coins, furniture, etc. For performing the appraisal, Company ABC charges a fee. Is the fee subject to Wisconsin sales tax?

Answer: No. Section 77.52(2), Wis. Stats. (1987-88), imposes a sales tax on the gross receipts from the sale, performance or furnishing of certain services. Of the services listed in sec. 77.52(2)(a)1 through 20, Wis. Stats. (1987-88), appraising is not included. Therefore, the appraisal fees are not subject to Wisconsin sales tax.

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2. Is Refurbishing or Remaking Railroad Cars and Freight Car Wheels Manufacturing?

Statutes: Section 77.54(6)(a) and (6m), Wis. Stats. (1987-88)

Wis. Adm. Code: Sections Tax 11.38, October 1976 Register, Tax 11.39 and 11.41, July 1987 Register, and Tax 11.40, November 1981 Register.

Facts and Question: Company XYZ (XYZ) operates a complete rail car repair center in Wisconsin. The facility is set up into functional areas, a freight car repair facility ("rip track"), a wheel shop where railroad wheel sets are retooled and rebuilt, and a passenger car refurbishing area.

The freight car "rip track" is where damaged freight cars are repaired. The repair facility is clearly not manufacturing, and is not at issue here.

In the "wheel shop" area, freight car wheel sets are retooled and rebuilt to specifications on an assembly line as follows:

a. Wheel sets are transported to XYZ by semi-trailer and unloaded at the plant sight.
b. The wheel sets are inspected to determine if any parts are salvageable.
c. The wheel sets are dismantled and reusable parts are retained.
d. The reusable parts are remanufactured and added with new parts to form new wheel sets which are placed into finished goods inventory.
e. The wheel parts are sold outright to rail car manufacturers, exchanged for scrap wheel sets, or sold to various railroads and rail car leasing companies.

As another part of XYZ's business, passenger rail cars are refurbished to customer specifications and by specific customer order at XYZ's main plant.

The scrap railroad car is towed to XYZ on rail lines or on flatbed cars. XYZ also maintains a stock pile of scrap railroad cars for those customers that do not wish to purchase and ship their own. Approximately 70% of the railroad cars refurbished are supplied by XYZ and the cost is included in the total contract price.

Once a contract is obtained to refurbish a railroad car, the car is pulled or pushed to XYZ's facility by XYZ's own switching locomotive. Then, the car is completely stripped of any remaining plumbing, electrical, and interior systems. The exterior shell and frame are inspected and damaged, decayed, worn, or rusted materials are removed.

XYZ has the following departments in its rebuilding operation: cabinet shop, electrical, painting, plumbing, engineering, and interior design.

The railroad car is completely overhauled and operations include replacing exterior shells, constructing open end platforms, and

rebuilding entrances, exits, and interiors, all to the customer's specification. New electrical, plumbing, heating, and ventilating systems are installed.

The value of a railroad car is as low as $10,000 before XYZ begins work and after 6 to 9 months of work, the car may be worth $350,000 to $600,000, depending upon the work involved.

The properties where the work on freight car wheels and railroad cars is done are currently zoned "M-1 Industrial." XYZ reports all equipment as manufacturing equipment used in the transformation of materials and components. XYZ considers itself exempt from personal property taxes.

The rebuilding of railroad cars is listed as a manufacturing activity under Section 3743 of the *Standard Industrial Classification Manual*, 1987 Edition.

a. Does the remanufacture, to original specifications, of railroad freight car wheels constitute manufacturing for Wisconsin sales and use tax purposes?
b. Does the refurbishing or remaking of railroad cars constitute manufacturing for Wisconsin sales and use tax purposes?

Answer:

a. Yes. The remanufacture of railroad freight car wheels, as performed by XYZ, constitutes manufacturing under sec. 77.54(6m), Wis. Stats. (1987-88). The situation is similar to that in the case of *Argyle Industries, Inc. vs. Wisconsin Department of Revenue*, (Docket No. I-8393, July 25, 1983). The Commission concluded in that case that Argyle's "remanufacturing" of automobile parts from new and used component parts constituted manufacturing.

b. Yes. The refurbishing or remaking or passenger railroad cars, to the degree and scale engaged in by XYZ, constitutes manufacturing under sec. 77.54(6m), Wis. Stats. (1987-88).

Note: The scope of this Tax Release only encompasses whether particular operations constitute manufacturing. The question of exclusive use of machinery and equipment in the manufacturing operations for purposes of sales and use tax exemptions is not addressed.

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PRIVATE LETTER RULINGS

"Private letter rulings" are written statements issued to a taxpayer by the department that interpret Wisconsin tax laws to the taxpayer's specific set of facts. Any taxpayer may rely upon the ruling to the same extent as the requestor, provided the facts are the same as those set forth in the ruling.

The number assigned to each ruling is interpreted as follows: The first two digits are the year issued, the next two digits are the week issued, and the last three digits are the number in the series of rulings issued that year. "Issued" means when the ruling is available to be published (80 days after being mailed to the requester). The date following the 7-digit number is the date the ruling was mailed to the requester.

Certain information contained in the ruling that could identify the taxpayer requesting the ruling has been deleted. Wisconsin Publication 111, "How to Get a Private Letter Ruling From the Department of Revenue," contains additional information about private letter rulings.

W 8927002, April 19, 1989

Type Tax: Sales/Use

Issue: Manufacturing Machinery and Equipment; Property Consumed in the Manufacturing Process

Statutes: Sections 77.54(2) and (6)(a), Wis. Stats. (1987-88)

This letter responds to your request for a private letter ruling regarding the classification of the production of microfiche as manufacturing for purposes of the sales tax exemption for machinery and equipment, s. 77.54(6)(a), and property consumed in manufacturing, sec. 77.54(2), Wis. Stats.

Facts: A operates a micrographics service business. The company receives computer tapes and cassettes in various electronic data formats from clients. This machine readable information is reprogrammed to satisfy client output format requirements. Microfiche copies of the data are produced, without conversion of the data through a paper report state.

In this process, A consumes supplies in the production of microfiche for clients including computer tapes, photographic sensitive film, processing chemicals, and paper packaging materials.

You have indicated that A has purchased equipment from DatagraphiX, Inc. of San Diego, California, and is financing the purchase through B a division of A. The cost of the equipment was $164,000 and the monthly financing lease payments are $5,326. Use tax was not paid on the acquisition from DatagraphiX nor on the lease payments, as A believes this equipment is being used exclusively in a manufacturing process.

A also purchases supplies which are consumed exclusively in the production of microfiche. A sells the reformatted information by transfer of the completed microfiche product.

You describe the process as involving the conversion of machine readable electronic data into a human readable format and you further describe the process as set forth below.

The film, the main component in the process, in its unprocessed form along with the chemicals are not an end product or in a usable form. The information received from the customer in the form of magnetic images on magnetic tape is reformatted and electronically transferred into a human readable form on the film. The film, at this point, has been permanently altered but is still light sensitive and retains no images placed on the film. Through the chemical processing, the image becomes unalterable and permanent on the film. Through cutting and shaping, the film becomes the usable end product, microfiche. The tangible property that entered the process is permanently altered.

Computer generated data is provided by customers on magnetic tape or cartridge for microfiche processing. The tapes or cartridges are loaded on the computer output microfilm system for processing. The system reads the data from the tape or cartridge, generates the data on a CRT tube inside the system, and flashes an image of the data on to film. The film is then processed and dried. Additional copies of the microfiche can be produced on a microfiche duplicator.

A has two complete systems for producing microfiche. Equipment includes two DatagraphiX auto-com recorders, two Datamaster duplicators, two cartridge tape units, and one tape drive.

Other equipment in the facility includes an Allen 16MM microfilm processor, an Extek 16MM Diazo duplicator, 2 micro-design microfilm viewers, and other related film handling devices such as rewinds, splicers, etc.

The production area is approximately 1,050 sq. ft. and is operated and staffed by 4 full-time employes and one part-time employe.

Ruling: The production of microfiche from customers' computer tapes, in the scope and to the extent engaged in by A, constitutes manufacturing for sales and use tax purposes. Thus, the machines and specific processing equipment used by A exclusively and directly in the production of microfiche are exempt from sales and use tax under sec. 77.54(6)(a) , Wis. Stats.

Exempt equipment includes the two DatagraphiX auto-com recorders, the two Datamaster duplicators, the two cartridge tape units, the tape drive, the Allen 16MM microfilm processor, the Extek 16MM Diazo duplicator, the 2 micro-design microfilm viewers, and the other related film handling devices such as rewinds, splicers.

Tangible personal property consumed or destroyed in the production of the microfiche or that becomes an ingredient or component part of the microfiche is exempt from sales tax under sec. 77.54(2), Wis. Stats. Examples of exempt property consumed or destroyed in the manufacturing process include the auto-pos film and chemistry used to produce the finished microfiche and the diazo film and ammonia to produce duplicates.

Analysis: Section 77.54(6)(a), Wis. Stats., provides an exemption for "machines and specific processing equipment and repair parts or replacements thereof, exclusively and directly used by a manufacturer in manufacturing tangible personal property."

The term "manufacturing" as used in sec. 77.54(6)(a), Wis. Stats., is defined in sec. 77.54(6m), Wis. Stats., to mean "the production by machinery of a new article with a different form, use, and name from existing materials by a process properly regarded as manufacturing."

The concept that the microfilming (e.g., producing of microfiche) of customer's records constitutes manufacturing was affirmed in *Valley Microforms, Inc. vs. DOR*, Wisconsin Tax Appeals Commission decision dated May 30, 1984. Based on the information provided, A is engaged in the business of producing microfiche and duplicates of microfiche to a sufficient extent as to be regarded as engaged in manufacturing.

Manufacturing machinery must be used exclusively and directly in the manufacturing process to qualify for the exemption. "Exclusively" as defined in sec. Tax 11.40(1)(a), Wis. Adm. Code, and as used in sec. 77.54(6)(a), Wis. Stats., means that the machines and specific processing equipment are used solely by a manufacturer in manufacturing tangible personal property to the exclusion of all other uses, except that the sales and use tax exemption will not be invalidated by an infrequent and sporadic use other than in manufacturing tangible personal property.

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W 8927003, April 19, 1989

Type Tax: Sales/Use

Issue: Manufacturing Equipment - Book Binding

Statutes: Section 77.54(6)(a) and (6m), Wis. Stats. (1987-88)

This letter responds to your request for a private letter ruling regarding the sales and use tax status of certain binding equipment.

1. A, a nonprofit organization, is the sole shareholder of B.

2. B (taxpayer) has two lines of business operations. The primary business operation is the provision of bindery services to printers servicing the public and private sectors. For example, taxpayer has accepted bindery contracts for various national magazine publications.

3. An important although secondary business operation of taxpayer is its mailing service support business. This operation assists Wisconsin printers by wrapping, addressing, and mailing supplemental magazines and brochures to subscribers. An agreement with the United States Postal Service enables the taxpayer to perform on-site stamping and ship-

ment of the wrapped and finished materials from the business location.

4. B has recently acquired financing for the purpose of acquisition of certain equipment to be used exclusively in its bindery manufacturing process. These machines include paper cutters, stitchers, folding machines, drills, and a saddle stitcher. Taxpayer uses these machines by taking printed materials and then cutting, folding, binding, and wrapping them so that they may be provided to the end user. Set forth below is a description of the equipment in question ("Bindery Equipment"):

   Saddle Stitching Machine: This machine is used in taxpayer's basic binding line to assemble printed paper, trim it, and bind it into a final finished product. The finished product would typically be a catalog or a weekly magazine publication. A picture of and operational data concerning the saddle stitcher was attached to your request as Exhibit A.

   Folding Machine: This machine is used in conjunction with the saddle stitcher to fold flat press sheets into multiple pages which can be assembled into a final printed product. A picture of and operational data concerning the folding machine was attached to your request as Exhibit B.

   Paper Cutter: This machine is used to cut paper so that it can be folded and stitched into the final printed product. A picture of and operational data concerning the folding machine was attached to your request as Exhibit C.

   Collator: This machine gathers flat press sheets together into a form that can then be fed into the folding machine, paper cutter, and saddle stitcher for production of the final printed product.

   Upright Stitcher: This machine is a smaller version of the saddle stitcher that is used to stitch (bind) small quantity jobs and is used to correct stitching flaws which occur in larger runs on the saddle stitcher.

   Electro Spiro Punch: This machine is used to punch holes in paper so that it can then be bound in a spiral metal wire process by the electric spiro binder.

   Electro Spiro Binder: This machine is used to thread spiral metal wire through assembled paper sheets to produce items such as technical manuals and spiro binder notebooks.

   Five Head Drill: This machine is used to drill holes through paper so that it can be assembled in the binding process.

Ruling Request: You state that the operative transaction giving rise to this ruling request is the purchase of the Bindery Equipment by the taxpayer. The business purpose for the acquisition of this equipment is to permit the taxpayer to perform the necessary operations of its bindery business.

Based on the foregoing, you request that a ruling be issued providing that the Bindery Equipment is manufacturing equipment within the meaning of sec. 77.54(6)(a), Wis. Stats., and is therefore, exempt from the sales and use tax.

Ruling: The process of book binding, to the extent engaged in by B constitutes manufacturing under sec. 77.54(6m), Wis. Stats. The machines and processing equipment (Bindery Equipment) used by B exclusively and directly in the binding process qualifies for exemption under sec. 77.54(6)(a), Wis. Stats.

Providing a mailing service does not constitute manufacturing. Any bindery equipment also used in providing the mailing service (except for infrequent and sporadic use) would violate the exclusive use requirement of sec. 77.54(6)(a), Wis. Stats., and thus, void the exemption.

Analysis: Section 77.54(6)(a), Wis. Stats., provides an exemption for "machines and specific processing equipment and repair parts or replacements thereof, exclusively and directly used by a manufacturer in manufacturing tangible personal property."

The term "manufacturing" as used in sec. 77.54(6)(a), Wis. Stats., is defined in sec. 77.54(6m), Wis. Stats., to mean "the production by machinery of a new article with a different form, use, and name from existing materials by a process properly regarded as manufacturing."

The Bindery Equipment is used to produce books and magazines in a bound and finished form from source materials that are essentially loose printed papers. The Bindery Equipment takes the loose printed paper, cuts it to size, drills holes in it for stitching, folds it, and then stitches it together with a covering material to produce a finished product in a different shape or form than the source materials. This description falls within the definition of manufacturing found in sec. 77.54(6m), Wis. Stats., because the Bindery Equipment is used to produce a new article with a form, use, and name that is different than the source materials.

Manufacturing machinery must be used exclusively and directly in the manufacturing process. Since mailing services are not considered manufacturing, the machines and equipment used in the mailing service do not qualify for the exemption. In addition, any Bindery Equipment also used in the providing of mailing services would not qualify for the exemption in sec. 77.54(6)(a), Wis. Stats., because it is not used exclusively in the manufacturing (binding) process.

"Exclusively" as defined in sec. Tax 11.40(1)(a), Wis. Adm. Code, and as used in sec. 77.54(6)(a), Wis. Stats., means that the machines and specific processing equipment are used solely by a manufacturer in manufacturing tangible personal property to the exclusion of all other uses, except that the sales and use tax exemption will not be invalidated by an infrequent and sporadic use other than in manufacturing tangible personal property.

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W 8927004, April 19, 1989

Type Tax: Individual Income

Issue: Proration of Itemized Deduction Credit - Part-Year Resident

Statutes: Section 71.07(5), Wis. Stats. (1987-88)

This is in reply to your ruling request concerning the proration of the Wisconsin itemized deduction credit.

Facts: You were part-year residents of Wisconsin for taxable year 1988 and have submitted Wisconsin Form 1NPR and Schedule 1 (Wisconsin Itemized Deduction Credit). The Wisconsin itemized deduction credit is discounted (prorated) on Form 1NPR by a ratio of Wisconsin income to federal income. Two of the items used to compute the Wisconsin itemized deduction credit ("interest paid on your principal residence" and "moving expenses") pertain to only your Wisconsin income. The mortgage interest was paid for a home located in Wisconsin and reimbursement for moving expenses is included in Wisconsin income.

Request: You specifically request that the portion of the Wisconsin itemized deduction credit which is attributable to mortgage interest and moving expenses not be prorated and the tax liability be calculated accordingly.

Ruling: Wisconsin law provides that part-year residents must prorate the Wisconsin itemized deduction credit based on the ratio of Wisconsin adjusted gross income to federal adjusted gross income. There is no provision in Wisconsin law to allow part-year residents to prorate certain portions of the Wisconsin itemized deduction credit and not prorate other portions.

Analysis: Section 71.07(5), Wis. Stats. (1987-88), provides for the computation of the Wisconsin itemized deduction credit. Paragraph (d) provides that "With respect to persons who change their domicile into or from this state during the taxable year and nonresident persons, the credit under this subsection shall be limited to the fraction of the amount so determined that Wisconsin adjusted gross income is of federal adjusted gross income."

Accordingly, as a part-year resident of Wisconsin for 1988, you must prorate the total amount of your Wisconsin itemized deduction credit, including the portion attributable to moving expenses and interest paid for a home located in Wisconsin. The statute is clear and the department has no alternative to permit any other method than that authorized by the statute.

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W 8930005, May 8, 1989

Type Tax: Corporation Franchise or Income

Issue: Net Business Loss Carryforward - Merger

Statutes: Section 71.26(3), Wis. Stats. (1987-88)

This letter responds to your request for a private letter ruling regarding the proposed statutory merger transaction and the effect on the Wisconsin net business loss carryforwards of the merged corporations.

Facts: In your letter you state that Parent, a Wisconsin corporation, is a publicly-held corporation with several wholly-owned subsidiaries. The taxpayer is contemplating the entering of a merger agreement between 3 of the wholly-owned subsidiaries. You state that such mergers will be effected pursuant to Internal Revenue Code section 368(a)(1)(A). The proposed merger transactions would be as follows:

(Sub B) into (Sub A)

and

(Sub C) into (Sub A)

Sub B, a Wisconsin corporation, holds the office building for the headquarters of Parent, in Wisconsin. Sub A, a Wisconsin corporation, and Sub C, a Kentucky corporation, are engaged in manufacturing. Sub A operates the assembly facilities in Wisconsin and Sub C operates the assembly facility in Kentucky.

The corporations are all on the accrual basis of accounting and are included in the consolidated federal income tax return of Parent. Sub B and Sub C both have net operating loss carryforwards for 1987, and estimated losses for the year 1988. You state that the losses of Sub B are attributable fully to Wisconsin and the Sub C losses are attributable fully to Kentucky. Sub A currently files in Wisconsin and Kentucky and has been profitable in recent years.

Request: You have requested that the following rulings be issued:

1. The proposed statutory mergers under the laws of the states of Wisconsin and Kentucky will qualify as an "A" reorganization under Internal Revenue Code section 368(a)(1)(A); and the 3 corporations qualify as "a party to a reorganization" under Internal Revenue Code section 368(b).

2. No gain or loss will be recognized pursuant to Internal Revenue Code section 361(a) to Parent or any other affiliated corporation as a result of the proposed statutory merger.

3. The assets and liabilities of Sub B and Sub C to be transferred to Sub A will retain the same tax basis as that of Sub B and Sub C in accordance with the provisions of Internal Revenue Code section 362(b).

4. Pursuant to Internal Revenue Code section 358(a), the basis of the stock received by Parent will equal the existing basis in Sub B and Sub C immediately prior to the merger transaction and the holding period of such stock will continue pursuant to Internal Revenue Code section 1223(1).

5. The Wisconsin net business loss carryforwards of the merged corporations will be available to the survivor corporation irrespective of continuance of the same trade or business.

6. The losses will not be subject to limitations under Internal Revenue Code section 382 and thus will be 100% available to the survivor corporation in the year of the merger.

Ruling:

1. If the proposed statutory mergers under the laws of the states of Wisconsin and Kentucky qualify as an "A" reorganization under Internal Revenue Code section 368(a)(1)(A) and the 3 corporations qualify as "a party to a reorganization" under Internal Revenue Code section 368(b) for federal income tax purposes, Internal Revenue Code section 368(a)(1)(A) and (b) will also apply for Wisconsin franchise and income tax purposes.

2. If no gain or loss is recognized pursuant to Internal Revenue Code section 361(a) to Parent or any other affiliated corporation for federal income tax purposes as a result of the proposed merger, Internal Revenue Code section 361(a) will also apply for Wisconsin franchise and income tax purposes.

3. If the assets and liabilities of Sub B and Sub C to be transferred to Sub A retain the same tax basis as that of Sub B and Sub C in accordance with the provisions of Internal Revenue Code section 362(b) for federal income tax purposes, Internal Revenue Code section 362(b) will also apply to their Wisconsin tax basis.

4. If, pursuant to Internal Revenue Code section 358(a), the basis of the stock received by Parent will equal the existing basis in Sub B and Sub C immediately prior to the merger transaction and the holding period of such stock will continue pursuant to Internal Revenue Code section 1223(1) for federal income tax purposes, Internal Revenue Code sections 358(a) and 1223(1) will also apply for Wisconsin franchise and income tax purposes.

5. The Wisconsin net business loss carryforwards of Sub B will be available to the survivor corporation as provided by Internal Revenue Code sections 381 and 382. For transactions occurring during the 1987 taxable year and thereafter, it is no longer necessary that the laws of the state under which the reorganization is accomplished provide for the continued existence of the dissolved corporation in the survivor. Since the losses of Sub C are attributable fully to Kentucky, they will not be available to the survivor corporation.

6. If the limitations under Internal Revenue Code section 382 do not apply for federal income tax purposes because the merger does not constitute an ownership change as defined in Internal Revenue Code section 382(g), the Wisconsin net business loss carryforwards of Sub B for 1980 and thereafter will be 100% available to the survivor corporation. Since the losses of Sub C are attributable fully to Kentucky, they will not be available to the survivor corporation.

Analysis: Beginning with the 1987 taxable year, the Wisconsin net income of a corporation is determined under the Internal Revenue Code, with certain modifications. The modifications to the Internal Revenue Code in section 71.26(3), Wis. Stats. (1987-88), do not include any modifications to Internal Revenue Code sections 358, 361, 362, 368, or 1223. Internal Revenue Code sections 381, 382, and 383 are modified so that they apply to Wisconsin net business loss carryforwards and Wisconsin credits instead of to federal net operating losses and federal credits. Internal Revenue Code section 381 first applies to mergers occurring in taxable year 1987. When such application is warranted, the successor corporation may utilize the predecessor corporation's unused Wisconsin net business loss carryforwards from 1980 and thereafter.

Since the Department of Revenue will not issue private letter rulings involving interpretations of the Internal Revenue Code, we will not rule that Internal Revenue Code sections 358(a), 361(a), 362(b), 368(a)(1)(A) and (b), and 1223(1) do apply, nor will we rule that Internal Revenue Code section 382 does not apply to this transaction.

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