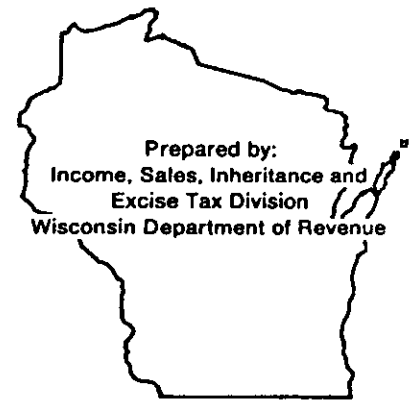


# WISCONSIN TAX BULLETIN

July 1991  
NUMBER 72

Subscriptions available from:

Wisconsin Department of  
Administration  
Document Sales  
P.O. Box 7840  
Madison, WI 53707  
Annual cost \$6.00



## NEW TAX LAWS

The Governor's Budget Bill and other tax bills were still pending at the time this Bulletin went to press. If any of these bills become law, a special issue of the *Wisconsin Tax Bulletin* will be published to provide information about the tax law changes.

## CRACKDOWN AGAINST TAX EVASION CONTINUES

The Wisconsin Department of Revenue's Intelligence Section investigators continue their crackdown on tax evasion throughout Wisconsin. Recent investigations have resulted in the arrests of nine Wisconsin men in connection with violations of Wisconsin's sales and use tax and income tax laws.

Four of the men were charged with filing a fraudulent sales and use tax statement in connection with motor vehicles they had purchased from private parties. The other five were charged with failing to file Wisconsin income tax returns, or filing false and fraudulent Wisconsin income tax returns.

Donald R. Jadin, 3528 Briar Terrace, Green Bay, and Richard Zuidmulder, 1977 Kane Lane, Green Bay, were both sentenced in Brown County Circuit Court, Green Bay, by Judge Carl R. Fenwick after they each pled guilty to one count of filing a false sales and use tax statement in connection with registration of motor vehicles they

In This Issue	
	Page
New Tax Laws .....	1
Crackdown Against Tax Evasion Continues .....	1
Topical/Court Case Index Available .....	2
1991 Estimated Tax Requirements for Estates and Trusts .....	2
Information or Inquiries? .....	2
Speakers Bureau .....	2
Administrative Rule Regarding Interest from Government Securities Amended ..	2
Refund Offset Programs .....	3
New ISI&E Division Rules and Rule Amendments in Process .....	3
Report on Litigation .....	4
Tax Releases	
Individual Income Taxes .....	6
Corporation Franchise or Income Taxes ..	7
Sales/Use Taxes .....	10
Private Letter Rulings .....	20
Administrative Rule s. Tax 3.095 .....	26
Order Blank for Topical/Court Case Index, Etc. ....	31

had purchased from private parties. They each understated the purchase price when registering the vehicles and paid less tax than was due. Judge Fenwick also ordered both men to make restitution of the taxes due.

Randall G. Springen, 6211 Bridge Road, Monona, was charged in Dane County Circuit Court, Madison, with one count of filing a fraudulent sales and use tax return in connection with the registration of a van he purchased from a private party in 1989. Franklin C. Buscher, Jr., 4041 South Brook Road, Franksville, was charged in Racine County Circuit Court, Racine, with one count of filing a fraudulent return in con-

nection with the registration of an automobile he purchased from a private party in 1990. The men were charged with filing false MV-1 reports, which are applications for motor vehicle title/registration combined with state sales and use tax forms.

Peter D. Herpst, 334 North Eight Street, River Falls, and Roland V. Travers, Trevor, were each charged with three counts of failing to file state income tax returns in each of the years 1988, 1989, and 1990. Herpst was charged in Pierce County Circuit Court, Ellsworth, and Travers was charged in Kenosha County Circuit Court, Kenosha. Alvord J. Ellingboe, Jr., 1130 Edgehill Drive, Madison, and William W. Fugate, 38 County Highway N, Edgerton, both accountants, were each charged in Dane County Circuit Court, Madison, with two counts of failing to file state income tax returns at the time required for the years 1988 and 1989.

Edward Mulloy, 10 Meadowbrook Lane, Appleton, was charged in Outagamie County Circuit Court with three counts of filing false and fraudulent state income tax returns. Mulloy was charged with failing to report taxable income in excess of \$75,000 and evading state income tax in excess of \$3,600 for the years 1984, 1985, and 1986.

Filing a false sales and use tax return is a crime punishable by a fine of up to \$500 or imprisonment for up to 30 days, or both. Failing to file a Wisconsin income tax return when required to do so is a crime punishable by a fine of up to \$10,000 or imprisonment for up to nine months, or

both. In addition to the criminal penalties, Wisconsin law provides for substantial civil penalties. Assessment and collection of the additional taxes, penalties, and interest due follows conviction for criminal violation.

## TOPICAL/COURT CASE INDEX AVAILABLE

If you need an easy way to research Wisconsin tax questions, you should consider subscribing to the Wisconsin Department of Revenue's Topical and Court Case Index. This index will help you find a particular Wisconsin statute, administrative rule, Wisconsin Tax Bulletin article, tax release, publication, Attorney General opinion, or court decision that deals with your particular Wisconsin tax question.

The index is divided into two parts. The first part, the "Topical Index," gives references to alphabetized subjects for the various taxes. The taxes include individual income, corporation franchise or income, sales/use, withholding, gift, estate and inheritance, cigarette, tobacco products, beer, intoxicating liquor and wine, and motor fuel.

The second part, the "Court Case Index," lists Wisconsin Tax Appeals Commission, Circuit Court, Court of Appeals, and Wisconsin Supreme Court decisions by alphabetized subjects for the various taxes.

The annual cost of this index is \$14, plus sales tax. To order your copy, complete the order blank that appears on page 31 of this Bulletin. The order blank may also be used for subscribing to the Wisconsin Tax Bulletin and for ordering the Wisconsin Administrative Code.

## 1991 ESTIMATED TAX REQUIREMENTS FOR ESTATES AND TRUSTS

Estimated income tax payments are tax deposits made during the year to prepay the income tax and minimum tax that will be due when an income tax return is filed.

Generally, an estate or trust (except trusts subject to tax on unrelated business income) is required to pay 1991 Wisconsin estimated tax if it expects to owe \$200 or more on a 1991 Wisconsin income tax return (Form 2). Form 1-ES, "1991 Wisconsin Estimated Tax Voucher," is filed with each estimated tax payment.

Grantor trusts which are funded on account of a decedent's death are only required to make estimated tax payments for taxable years which end two or more years after the decedent's death. For example, an individual died on April 25, 1991. A grantor trust which was funded on account of the individual's death is not required to make estimated tax payments for any taxable year ending before April 25, 1993.

For estates and trusts (except trusts subject to tax on unrelated business income), installment payments are due on the 15th day of the 4th, 6th, and 9th months of the taxable year and the 1st month of the following taxable year.

A trust which is subject to tax on unrelated business income is generally required to pay 1991 Wisconsin estimated tax if it expects to owe \$500 or more on a 1991 Wisconsin income tax return (Form 4T). Form 4-ES, "1991 Wisconsin Corporation Estimated Tax Voucher," is filed with each estimated tax payment. Installment payments for such trusts are due on the 15th day of the 3rd, 6th, 9th, and 12th months of the taxable year.

If an estate or trust does not make the estimated tax payments when required or underpays any installment, interest may be assessed.

## INFORMATION OR INQUIRIES?

**Madison - Main Office**  
Area Code (608)

Beverage, Motor Fuel,

Cigarette, Tobacco Products .266-6701  
Corporation Franchise/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 .....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

## SPEAKERS BUREAU

The department's Speakers Bureau provides speakers to professional organizations and community groups throughout Wisconsin. If you would like a speaker to address your group, please call the Speakers Bureau at (608) 266-8640.

Subjects that may be discussed include updates on individual income, corporate, sales, and withholding tax laws, audit procedures, common taxpayer errors, how tax laws apply to exempt organizations, sales tax problems of contractors or manufacturers, homestead credit, etc.

## ADMINISTRATIVE RULE REGARDING INTEREST FROM GOVERNMENT SECURITIES AMENDED

Section Tax 3.095 of the Wisconsin Administrative Code includes a listing of 80 federal, state, municipal, or other local government securities. The rule specifies whether interest or dividends payable on each of those securities is subject to or exempt from Wisconsin income taxes.

Effective July 1, 1991, s. Tax 3.095 was amended to include 25 additional securities not previously included in the listing. A copy of the amended rule appears on pages 26 to 29 of this Bulletin.

If you are interested in subscribing to the Wisconsin Administrative Code, you may use the order blank which appears on page 31 of this Bulletin.

## STATE TAX REFUND OFFSET PROGRAMS

Section 71.80(3) and (3m), Wis. Stats., provides that the Department of Revenue may apply a taxpayer's state tax refund against amounts owed to the department. Section 71.93, Wis. Stats., provides for refunds to be applied against debts that the taxpayer owes to another state agency, if the other agency has certified that debt to the Department of Revenue.

The following shows the amounts applied under sec. 71.80 (identified as Refund Offsets) and sec. 71.93 (identified as Agency Setoffs) for each of the fiscal years 1986-87 through 1989-90.

### REFUND OFFSETS

	1986-87	1987-88
Individual Income Tax	\$2,475,800	\$2,559,245
Corporation Income or Franchise Tax	36,000	34,126
Withholding	405,800	443,901
Sales Tax	1,778,700	1,644,155
Miscellaneous	3,200	5,952
<b>Total Refund Offsets</b>	<b>\$4,699,500</b>	<b>\$4,687,379</b>
	1988-89	1989-90
Individual Income Tax	\$2,942,232	\$3,781,529
Corporation Income or Franchise Tax	185,987	96,996
Withholding	581,072	560,418
Sales Tax	1,709,268	1,823,598
Miscellaneous	26,842	34,841
<b>Total Refund Offsets</b>	<b>\$5,445,401</b>	<b>\$6,297,382</b>

### AGENCY SETOFFS

	1986-87	1987-88
Health and Social Services	\$2,980,800	\$3,425,600
Transportation	8,400	4,600
Justice	0	300
Veterans Affairs	30,500	30,200
Industry, Labor & Human Relations	84,100	154,500
Natural Resources	0	900
<b>Total Agency Setoffs</b>	<b>\$3,103,800</b>	<b>\$3,616,100</b>

	1988-89	1989-90
Health and Social Services	\$3,741,500	\$5,988,469
Transportation	5,500	14,509
Justice	100	1,280
Veterans Affairs	23,400	30,750
Industry, Labor & Human Relations	147,200	238,786
Natural Resources	300	1,108
<b>Total Agency Setoffs</b>	<b>\$3,918,000</b>	<b>\$6,274,902*</b>

\*1989-90 Agency Setoffs amount includes set-offs of \$1,200,668 from the one-time additional school property tax/rent credit.

## 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 July 1, 1991. Part C lists new rules and amendments which became effective in the period from April 2, 1991 to July 1, 1991. 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 or Reviewed by Legislative Council Rules Clearinghouse

- 3.11 Member of a reserve component of the armed forces serving in the Desert Shield or Desert Storm theater of operations-NR
- 11.01 Sales and use tax return forms-A
- 11.05 Governmental units-A

- 11.33 Occasional sales-general-A
- 11.34 Sales of business or business assets-A
- 11.47 Commercial photographers and photographic services-A
- 11.50 Auctions-A
- 11.69 Financial institutions-A
- 11.83 Motor vehicles-A
- 11.84 Aircraft-A
- 11.85 Boats, vessels and barges-A
- 11.88 Mobile homes-A

### B. Rules at Legislative Standing Committee

- 4.05 Taxicabs-NR
- 4.54 Security requirements-NR
- 4.55 Ownership and name changes-NR
- 9.68 Ownership and name changes-NR
- 11.03 Elementary and secondary schools and related organizations-A

### C. Rules Adopted in Period From April 2, 1991 to July 1, 1991 (including effective date)

- 2.165 Change in taxable year-A (7/1/91)
- 2.39 Apportionment method-R&R (7/1/91)
- 2.40 Nonapportionable income-R (7/1/91)
- 2.48 Apportionment of net business incomes of interstate pipeline companies-A (7/1/91)
- 2.94 Tax sheltered annuities-A (7/1/91)
- 3.095 Income tax status of interest and dividends from municipal, state and federal obligations received by individuals and fiduciaries-A (7/1/91)
- 8.24 Reciprocal shipments of wine-NR (7/1/91)
- 11.001 Forward and definitions-A (7/1/91)
- 11.05 Governmental units-A (7/1/91)
- 11.10 Occasional sales-R (7/1/91)
- 11.11 Waste treatment facilities-A (7/1/91)
- 11.12 Farming, agriculture, horticulture and floriculture-A (7/1/91)
- 11.13 Sale of business or business assets-R (7/1/91)
- 11.16 Common or contract carriers-A (7/1/91)
- 11.26 Other taxes in taxable gross receipts and sales price-A (7/1/91)

- 11.29 Leases and rentals of tangible personal property-A (7/1/91)
- 11.30 Credit sales, bad debts and reposessions-A (7/1/91)
- 11.32 "Gross receipts" and "sales price"-A (7/1/91)
- 11.33 Occasional sales - general-NR (7/1/91)
- 11.34 Sales of business or business assets-NR (7/1/91)
- 11.35 Occasional sales exemption for nonprofit organizations-NR (7/1/91)
- 11.46 Summer camps-A (7/1/91)
- 11.50 Auctions-A (7/1/91)
- 11.51 Grocers' guidelist-A (7/1/91)
- 11.52 Coin-operated vending machines and amusement devices-A (7/1/91)
- 11.57 Public utilities-A (7/1/91)
- 11.63 Radio and television-A (7/1/91)
- 11.65 Admissions-A (7/1/91)
- 11.68 Construction contractors-A (7/1/91)
- 11.72 Laundries, drycleaners, and linen and clothing suppliers-A (7/1/91)
- 11.79 Leases of highway vehicles and equipment-A (7/1/91)
- 11.80 Sales of ice-A (7/1/91)
- 11.81 Industrial gases, welding rods and fluxing materials-A (7/1/91)
- 11.83 Motor vehicles-A (7/1/91)
- 11.84 Aircraft-A (7/1/91)
- 11.85 Boats, vessels and barges-A (7/1/91)
- 11.86 Utility transmission and distribution lines-R&R (7/1/91)
- 11.87 Meals, food, food products and beverages-A (7/1/91)
- 11.88 Mobile homes-A (7/1/91)
- 11.91 Successor's liability-A (7/1/91)
- 11.92 Records and record keeping-A (7/1/91)
- 11.93 Annual filing of sales tax returns-A (7/1/91)
- 11.94 Wisconsin sales and taxable transportation charges-A (7/1/91)
- 11.96 Interest rates-A (7/1/91)

#### D. Emergency Rules

- 3.11 Member of a reserve component of the armed forces serving in the Desert Shield or Desert Storm theater of operations-NR (effective 4/29/91)

## REPORT ON LITIGATION

*This portion of the Wisconsin Tax Bulletin 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 has 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

David P. McCarthy and Susan C. Pearsall (p. 4)  
Independent contractor vs. employee

#### Corporation Franchise or Income Taxes

Appleton Papers, Inc. (p. 5)  
Business loss carryforward — merger

Sentry Financial Services Corporation (p. 5)  
Allocation of income — between affiliates

#### Sales/Use Taxes

Arndt Enterprises, Inc. (p. 5)  
Farming — ginseng raising

#### Other

M & I Bank of Plover (p. 5)  
DTCS — delinquent tax payment application — foreclosure proceeds

## INDIVIDUAL INCOME TAXES

**Independent contractor vs. employee.**  
*David Paul McCarthy and Susan Carter Pearsall vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, January 29, 1991). The issue in this

case is whether David P. McCarthy ("the taxpayer") was an independent contractor ("I/C") teacher as claimed on his joint Wisconsin return and related U.S. individual income tax return, including various schedules, for the calendar year 1988. The taxpayer and Susan C. Pearsall, his wife, are both parties to this appeal solely by virtue of their joint filing of a 1988 Wisconsin income tax return for nonresidents and part-year residents.

Based on the taxpayer's claimed I/C status, he filed a federal Schedule C, Profit or Loss from Business (Sole Proprietorship), reporting gross receipts and taking deductions therefrom. Despite this filing, he filed no Schedule SE, Social Security Self-Employment Tax form.

The taxpayer contended that he established independent contractor status under the "20-factor test" of Treasury Regulations promulgated under the Internal Revenue Code. However, these factors are intended only as guides. "The degree of importance of each factor varies depending on the occupation and the factual context in which services are performed." Treas. Reg. § 31.3401(d)-1(h).

Upon evaluating the 20 factors and considering the nature of teaching services in institutions of higher education, the Commission concluded that while some of the factors might indicate I/C status, there are more which would clearly indicate employment, and those factors which are inconclusive or inapplicable work to the taxpayer's detriment, since it is his burden to show the assessment is incorrect. The Commission held that the taxpayer's work arrangement during 1988 must be considered employment and, therefore, he was not entitled to file a Schedule C or deduct expenses of a sole proprietorship.

The taxpayers have not appealed this decision.

**CAUTION:** This is a small claims decision of the Wisconsin Tax Appeals Commission and may not be used as a precedent. This decision is provided for informational purposes only.



## CORPORATION FRANCHISE OR INCOME TAXES

**Business loss carryforward — merger.** *Wisconsin Department of Revenue vs. Appleton Papers, Inc.* (Court of Appeals, District IV, March 28, 1991). The Wisconsin Department of Revenue appeals from a judgment and an order of the Circuit Court of Dane County, affirming a Wisconsin Tax Appeals Commission decision. The issue is whether a corporation may carry forward a tax credit earned by a predecessor corporation under sec. 71.043(3), Wis. Stats. (1982-84). See *Wisconsin Tax Bulletin* 63, page 10, and *Wisconsin Tax Bulletin* 69, page 9, for summaries of the prior decisions.

The taxpayer, Appleton Papers, Inc. (API/2) was created as a product of a merger. Germaine Monteil Cosmetics Corporation merged five of its subsidiaries into itself and changed its name to Appleton Papers, Inc. One of the defunct subsidiaries was also known as Appleton Papers, Inc. (API/1). API/1 ran a paper business in Wisconsin. In 1981 it earned a credit against its tax liability for sales and use taxes that it paid on fuel and electricity consumed in its manufacturing process. The full credit could not be used because the credit exceeded API/1's 1981 tax liability. API/2, which now operated the same paper manufacturing business that had been operated by API/1, claimed API/1's unused sales and use tax credit on its franchise tax returns. The department disallowed the credit. On appeal, the Commission reversed the department, and the Circuit Court affirmed the Commission's decision.

The Court of Appeals concluded that sec. 71.043(3), Wis. Stats. (1982-84), does not grant corporations the tax benefit of carrying forward a sales and use tax credit earned by a predecessor corporation.

The taxpayer has appealed this decision to the Wisconsin Supreme Court.

□

**Allocation of income — between affiliates.** *Wisconsin Department of Revenue*

*vs. Sentry Financial Services Corporation, and Sentry Financial Services Corporation vs. Wisconsin Department of Revenue* (Court of Appeals, District IV, March 28, 1991). The Wisconsin Department of Revenue appeals from a judgment and an order of the Circuit Court of Portage county, affirming a decision of the Wisconsin Tax Appeals Commission. The taxpayer, Sentry Financial Services Corporation (SENCO), cross-appeals. The issues in the case are whether SENCO's sale of a plane to the Sentry Corporation was a "bargain sale" within the meaning of sec. 71.11(7m), Wis. Stats. (1981-82), thus giving the department authority to reallocate income between subsidiary and parent corporations to more "clearly reflect" their income, and whether the gain on the transaction was nonrecognizable under sec. 71.311(1)(b), Wis. Stats. (1981-82), which declares certain intra-family corporate distributions to be tax-free. See *Wisconsin Tax Bulletin* 68, page 9, for a summary of the prior decision.

The case arose from a 1982 transfer by SENCO of a corporate airplane to its parent company, Sentry Corporation (SENCOR) in exchange for a payment of \$453,560. SENCO had purchased the plane in 1972 and leased it to SENCOR's parent company, Sentry Insurance, for ten years. SENCO, taking the position that the 1982 transaction was simply a "buyout" at the end of the Sentry lease, did not report any taxable gain on the transaction. The department considered the transaction to be a "bargain sale" between interrelated businesses within the meaning of sec. 71.11(7m), Wis. Stats., and thus allocated a taxable gain to SENCO. The Commission held, and the Circuit Court affirmed, that the transaction was a "bargain sale" between commonly owned corporations, but that the gain on the transaction was not taxable, because of the nonrecognition-of-gain provisions of sec. 71.311(1)(b), Wis. Stats.

The Court of Appeals concluded that the Commission's "bargain sale" conclusion is supported by substantial evidence and thus applies, but that because there is no evasion of tax and no distortion of income not sanctioned by the nonrecognition provisions of sec. 71.311(1)(b), Wis. Stats.,

the department erred when it allocated income to SENCO under sec. 71.11(7m), Wis. Stats.

The department has not appealed this decision.

□

## SALES/USE TAXES

**Farming — ginseng raising.** *Arndt Enterprises, Inc. vs. Wisconsin Department of Revenue* (Court of Appeals, District IV, January 31, 1991).

A summary of the Court of Appeals decision appeared in *Wisconsin Tax Bulletin* 71, page 10. The summary stated that the taxpayer had appealed the decision to the Wisconsin Supreme Court. The Wisconsin Supreme Court denied the petition for review on April 9, 1991.

□

## OTHER

**DTCS — delinquent tax payment application — foreclosure proceeds.** *M.&I. Bank of Plover vs. Robert R. and Marcia E. Mabie, and Wisconsin Department of Revenue* (Circuit Court of Portage County, February 28, 1991). The State of Wisconsin requested the Circuit Court to reconsider a previous Order, vacate its decision, and render an Order requiring the payment of the surplus proceeds of a foreclosure sale, to the State. The issue in this case is whether the surplus proceeds of the foreclosure sale initiated by a private mortgage lender are exempt under sec. 815.20, Wis. Stats. (1989-90), from collection by the department, pursuant to tax liens.

The department filed a claim to the surplus proceeds of the foreclosure, based upon three delinquent tax warrants filed in Portage County against the former joint owner of the property sold, Robert Mabie. He and his spouse, Marcia Mabie, also filed a claim to the surplus funds, based upon the homestead exemption under sec. 815.20, Wis.

Stats. (1989-90). Marcia Mabie was paid one-half of the surplus proceeds.

The Circuit Court concluded that the surplus proceeds are not protected by the homestead exemption. The lien acquired

by the department is a statutory lien, and property is not exempt in any proceeding brought by any person against the holder of a statutory lien. The Circuit Court thus vacated its previous Order and found that

the balance of the surplus proceeds should be delivered to the department.

This decision has not been appealed.

□

## TAX RELEASES

*"Tax Releases" are designed to provide answers to the specific tax questions covered, based on the facts indicated. In situations where the facts vary from those given herein, the answers may not apply. 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

1. Sale of an Installment Obligation by a Nonresident of Wisconsin (p. 6)
2. Taxability of Interest from Veterans' Administration Life Insurance Policy (p. 7)
3. Taxable Status of IRA Distribution Where Principal Contributed to the IRA Was Exempt from Wisconsin Tax (p. 7)

### Corporation Franchise or Income Taxes

1. Bad Debt Deduction Allowable to Credit Unions (p. 7)
2. Sales Factor - No Throw Back of Sales Due to Nexus With Destination State (p. 9)

### Sales/Use Taxes

1. Advertising and Related Transactions (p. 10)
2. Charge for Disposal of Tangible Personal Property (p. 13)
3. Donation vs. Sale at Retail (p. 14)
4. Municipal Water Softener (p. 15)
5. Sales and Purchases by Federal Credit Unions (p. 15)
6. Services Performed on Utility Right-of-Way (p. 16)
7. Taxability of Computer Software (p. 16)
8. Tire Fee on New Vehicles (p. 19)
9. Trade-In of Solely-Owned and Leased Automobiles (p. 19)

## INDIVIDUAL INCOME TAXES

1. Sale of an Installment Obligation by a Nonresident of Wisconsin

Statutes: Sections 71.01(6) and 71.04(1)(a), Wis. Stats. (1989-90)

Wis. Adm. Code: Section Tax 2.95, March 1991 Register

Note: This Tax Release applies only with respect to sales and exchanges of installment obligations occurring on or after April 1, 1991.

Background and Question: Section 71.04(1)(a), Wis. Stats. (1989-90), provides that income or loss of nonresident individuals from the sale of real property or tangible personal property shall follow the situs of the property. Income or loss of nonresident individuals derived from land contracts, mortgages, stocks, bonds, and securities or from the sale of similar intangible personal property shall follow the residence of such persons.

Internal Revenue Code section 453B(a) provides that any gain or loss resulting from the disposition of an installment obligation shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received.

Is the gain or loss from the sale of an installment obligation by a nonresident taxable to Wisconsin?

Answer: Gain or loss on the sale of an installment obligation by a nonresident is taxable to Wisconsin where the installment obligation resulted from the sale of real property or tangible personal property located in Wisconsin. Gain or loss on the sale of an installment obligation by a nonresident is not taxable to Wisconsin where the installment obligation resulted from the sale of intangible personal property or from the sale of real property or tangible personal property located outside Wisconsin. Since Wisconsin has adopted the definition of adjusted gross income as defined by the Internal Revenue Code, section 453B(a) of the Internal Revenue Code controls to classify the sale of an installment obligation as the sale of real property, personal property, or intangible personal property before applying the situs of income rules prescribed by Wisconsin law.

Example: In 1989 a nonresident of Wisconsin sold real estate located in Wisconsin for \$140,000. The adjusted basis of the property was \$70,000 which resulted in a gross profit percentage of 50%. The taxpayer received \$40,000 down and an installment note for \$100,000. The gross profit of \$20,000 (\$40,000 x 50%) was included in 1989 Wisconsin taxable income. An additional \$50,000 was paid off in 1990 of which \$25,000 (\$50,000 x 50%) was included in 1990 Wisconsin taxable income. The installment obligation is sold for \$55,000 in May 1991. The gain on the sale of the installment obligation which is taxable to Wisconsin for 1991 is computed as follows:

Selling price of installment obligation	\$55,000
Basis:	
Unpaid balance	\$50,000
Less profit due (50% x \$50,000)	<u>25,000</u>
Basis	<u>25,000</u>
Gain on sale of installment obligation taxable to Wisconsin	<u>\$30,000</u>

□

## 2. Taxability of Interest from Veterans' Administration Life Insurance Policy

**Statutes:** Section 71.05(6)(a)1, Wis. Stats. (1989-90)

**Note:** This Tax Release applies for all years open to adjustment and supersedes the Tax Release titled "Taxability of Interest from Veterans Administration Life Insurance Policy" in *Wisconsin Tax Bulletin #57*, July 1988.

**Background:** Previously, interest income earned on dividends left on deposit with the Veterans' Administration (now Department of Veterans' Affairs) was taxable for both federal and Wisconsin income tax purposes pursuant to Rev. Rul. 57-441. This Revenue Ruling held that interest credited to the account of a veteran on dividends accumulated by the Veterans' Administration on a converted United States Government Life Insurance policy, or on a National Service Life Insurance policy, was not a "veterans' benefit" under 38 U.S.C. § 3101(a). Payments of benefits by the Veterans' Administration are exempt from taxation under 38 U.S.C. § 3101(a). On February 15, 1991, the Internal Revenue Service issued Rev. Rul. 91-14 which revokes Rev. Rul. 57-441. As a result, interest earned on dividends left on deposit with the Veterans' Administration is not subject to federal income tax.

**Question:** Is interest income earned on dividends left on deposit with the Veterans' Administration (now Department of Veterans' Affairs) on a life insurance policy subject to Wisconsin income tax?

**Answer:** No. Because Rev. Rul. 57-441 no longer applies, such interest income is considered a "veterans' benefit." Wisconsin is prohibited by 38 U.S.C. § 3101(a) from taxing veterans' benefits. Therefore, no addition modification is required under sec. 71.05(6)(a)1, Wis. Stats., to add the amount of such interest to federal adjusted gross income when computing Wisconsin taxable income.

□

## 3. Taxable Status of IRA Distribution Where Principal Contributed to the IRA Was Exempt from Wisconsin Tax

**Statutes:** Section 71.05(1)(a), Wis. Stats. (1989-90)

**Background:** Section 71.05(1)(a), Wis. Stats. (1989-90), provides an exemption from Wisconsin income tax for all payments received from certain retirement systems if such amounts are paid on the account of a person who was a member of, or retired from, the system as of December 31, 1963. The affected retirement systems are:

- (a) United States government civilian employee and military employee retirement systems.
- (b) Employee's Retirement System of the City of Milwaukee.
- (c) Milwaukee County Employees' Retirement System.
- (d) Sheriff's Annuity and Benefit Fund of Milwaukee County.
- (e) Police Officer's Annuity and Benefit Fund of Milwaukee.
- (f) Fire Fighter's Annuity and Benefit Fund of Milwaukee.
- (g) Public Employee Trust Fund as successor to the Milwaukee Public School Teachers' Annuity and Retirement Fund.
- (h) Wisconsin State Teachers' Retirement System.

**Facts and Question:** An individual was a member of the Wisconsin State Teachers' Retirement System as of December 31, 1963. The individual receives a lump-sum distribution from the Wisconsin Retirement System which is based on membership in the Wisconsin State Teachers' Retirement System and qualifies for the exemption in sec. 71.05(1)(a), Wis. Stats. (1989-90). The lump-sum distribution is rolled over into an Individual Retirement Account (IRA) and, therefore, is not includible in federal adjusted gross income in the year received.

When amounts are distributed from the IRA, will any portion of such distribution qualify for the exemption from Wisconsin tax provided by sec. 71.05(1)(a), Wis. Stats. (1989-90)?

**Answer:** No. The IRA distributions do not qualify for the exemption under sec. 71.05(1)(a), Wis. Stats. (1989-90). The distributions are payments from the IRA trust account and are not payments from the Wisconsin State Teachers' Retirement System. Only direct distributions to a taxpayer from the retirement systems listed in sec. 71.05(1)(a) are exempt from income tax.

□

## CORPORATION FRANCHISE OR INCOME TAXES

### 1. Bad Debt Deduction Allowable to Credit Unions

**Statutes:** Section 71.26(1)(a) and (2)(a), Wis. Stats. (1989-90)

**Note:** This Tax Release applies with respect to the 1987 taxable year and thereafter.

**Background:** For federal income tax purposes, credit unions without capital stock, organized and operated for mutual purposes and without profit, are exempt from tax under sec. 501(c)(14) of the Internal Revenue Code (IRC). Federal credit unions may be exempt under IRC sec. 501(c)(1).

The federal exemptions under IRC sec. 501 do not apply for Wisconsin purposes but are replaced with the exemptions provided under Wis. Stat. sec. 71.26(1). Sec. 71.26(3)(p), Wis. Stats. (1989-90). A credit union is subject to Wisconsin franchise or income taxation only on the income that is derived from public deposits for any taxable year in which the credit union is approved as a public depository under chapter 34 of the Wisconsin Statutes and acts as a depository of state or local funds under Wis. Stat. sec. 186.113(20). Sec. 71.26(1)(a), Wis. Stats. (1989-90).

The income of a credit union that is derived from public deposits is the product of the credit union's gross annual income for the taxable year multiplied by a fraction, the numerator of which is the average monthly balance of public deposits in the credit union during the taxable year, and the denominator of which is the average monthly balance of all deposits in the credit union during the taxable year. Sec. 71.26(1)(a), Wis. Stats. (1989-90). A credit union may elect to compute its Wisconsin net income either by (a) applying the percentage of public deposits to its entire net income or (b) applying the percentage of public deposits to its annual gross income and to expenses indirectly related to public deposit income and deducting 100% of the expenses directly related to income from public deposits.

In computing its entire net income for Wisconsin purposes for 1986 and prior taxable years, a credit union was allowed to claim a bad debt deduction of either (a) two-thirds of the amount it was required to allocate to its loss reserves pursuant to statutory provisions or rules and regulations or orders of any state or federal governmental supervisory authority [sec. 71.04(9)(b), Wis. Stats. (1985-86)], or (b) the actual bad debts sustained during the year [sec. 71.04(7), Wis. Stats. (1985-86)]. Since this was an annual election, a credit union could claim whichever deduction was greater each year.

Beginning with the 1987 taxable year, Wisconsin net income is computed under the Internal Revenue Code as defined for Wisconsin purposes, with certain modifications. Sec. 71.26(2)(a), Wis. Stats. (1989-90). The modifications are provided in sec. 71.26(3), Wis. Stats. (1989-90). The Internal Revenue Code sections relating to the treatment of bad debts (secs. 166, 585, and 593) are not modified for Wisconsin purposes; they generally apply in computing Wisconsin net income.

Section 166(a), IRC, provides for the deduction of debts which become worthless during the taxable year. Thus, most taxpayers must use the direct write-off (or specific charge-off) method to deduct bad debts. However, in lieu of the deduction for bad debts actually written off, certain financial institutions may claim a deduction for a reasonable addition to a reserve for bad debts under IRC sec. 585 or sec. 593, as appropriate.

Section 585, IRC, allows "small banks" (those with assets of \$500 million or less) to use the reserve method of accounting for bad debts. Large banks must use the specific charge-off method. For purposes of the bad debt deduction under sec. 585, the term "bank" means any bank, as defined in IRC sec. 581, other than an organi-

zation to which sec. 593 applies. Section 581 defines a sec. 585 bank as

a bank or trust company incorporated and doing business under the laws . . . of any State, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks . . . and which is subject by law to supervision and examination by State authority . . . .

Section 593, IRC, provides that the reserve method of computing deductions for bad debts may be used by (a) any domestic building and loan association, (b) any mutual savings bank, and (c) any cooperative bank without capital stock organized and operated for mutual purposes and without profit.

**Question 1:** Must a credit union use the specific charge-off method for deducting bad debts or may it elect to use the reserve method of accounting for bad debts and claim a deduction for an addition to a reserve for bad debts as provided under IRC sec. 585 or sec. 593?

**Answer 1:** If a credit union actually engages in either the business of making commercial loans or the exercise of trust powers, it will be treated as a sec. 585 bank and may elect to use the reserve method for deducting bad debts as provided under IRC sec. 585. A credit union is not a sec. 593 financial institution and, therefore, is not eligible for the bad debt deduction under IRC sec. 593. A credit union which does not make commercial loans or exercise trust powers must use the specific charge-off method for deducting bad debts.

**Question 2:** May a credit union annually elect to deduct the greater of the addition to the reserve for bad debts or the actual bad debts written off during the taxable year?

**Answer 2:** No, a credit union does not have the option of deducting the greater of the addition to the reserve for bad debts or the actual bad debts written off. The method for computing and deducting bad debts is a method of accounting under the Internal Revenue Code. A credit union may change its method of accounting for bad debts in the manner specified in federal law and must make any adjustments necessary to prevent the omission or duplication of a deduction as required under IRC sec. 481.

**Question 3:** How does a credit union compute its allowable bad debt deduction under the reserve method?

**Answer 3:** A credit union which uses the reserve method must compute its bad debt deduction under IRC sec. 585(b). For the 1987 taxable year, a credit union could base the addition to its reserve for bad debts on either the percentage-of-outstanding-debt method or the experience method. For 1988 and thereafter, only the experience method may be used.

Under the percentage method, deductions were permitted to the extent necessary to increase the bad debt reserve to 0.6% of the



outstanding eligible loans. Under the experience method, a credit union may add to its bad debt reserve the amount computed on the basis of its actual experience as shown by losses for the current year and the 5 preceding taxable years.



## 2. Sales Factor — No Throw Back of Sales Due to Nexus With Destination State

**Statutes:** Section 71.25(9)(b), Wis. Stats. (1989-90)

**Wis. Adm. Code:** Sections Tax 2.39(5)(c)6, January 1978 Register and Tax 2.82 (1)(a), (3)(b), and (4)(a)6, 8, and 10, January 1979 Register

**Note:** For additional information about throwback sales, refer to the Tax Releases titled "Sales Factor — Throw Back of Sales Due to Insufficient Nexus With Destination State," published in *Wisconsin Tax Bulletin* 69 (October 1990), and "Sales Factor — Throw Back of Sales From States in Which a Combined or Consolidated Return Is Filed," published in *Wisconsin Tax Bulletin* 63 (October 1989).

**Background:** A multistate corporation with operations in Wisconsin must report a portion of its net income to Wisconsin using the apportionment method if its Wisconsin operations are part of a unitary business. The apportionment formula used by most multistate corporations consists of a property factor, payroll factor, and sales factor. The numerator of the sales factor is the taxpayer's total sales allocated to Wisconsin during the taxable year and the denominator is the taxpayer's total sales everywhere.

For purposes of computing the sales factor, sales of tangible personal property are included in the numerator of the sales factor at 100 percent if shipped to a Wisconsin location and at 50 percent if the property is shipped from a location in Wisconsin to a location in another state and the taxpayer is not within the jurisdiction, for income or franchise tax purposes, of the destination state. Sec. 71.25(9)(b)3, Wis. Stats. Under Public Law 86-272, a state may not impose its income tax or franchise tax based on net income on a corporation selling tangible personal property if that corporation's only activity in the state is the solicitation of orders, which orders are approved outside the state and are filled by delivery from a point outside the state. If there is any activity in the state which exceeds solicitation, the immunity from taxation under Public Law 86-272 is lost. Sec. Tax 2.82(3)(b)1, Wis. Adm. Code.

**Facts and Question 1:** ABC Corporation does business in and outside Wisconsin and is subject to Wisconsin franchise tax. ABC Corporation's activities in State Y consist of employees who:

- a) Conduct training courses, seminars, and lectures
- b) Provide shipping information and coordinate deliveries

- c) Carry samples for sale, exchange or distribution in any manner for consideration or other value
- d) Solicit sales of services — sales of a computerized ordering service for the ordering of parts
- e) Repossess property

ABC Corporation also owns property in State Y in the form of tooling equipment used by suppliers to produce parts marketed by ABC Corporation. State Y imposes its income tax on corporations which have activities that create nexus in State Y. Public Law 86-272 applies to State Y's corporation income tax for the purpose of determining nexus.

Are ABC Corporation's sales shipped from Wisconsin to State Y treated as Wisconsin sales and thrown back to Wisconsin to be included in the numerator of its sales factor?

**Answer 1:** No. ABC Corporation's sales shipped from Wisconsin to State Y are not thrown back to Wisconsin because ABC Corporation has nexus in and is subject to State Y's corporation income tax. ABC Corporation's activities in State Y exceed the protection of Public Law 86-272.

**Facts and Question 2:** DEF Corporation, which is a wholly-owned subsidiary of XYZ Corporation, does business in and outside Wisconsin and is subject to Wisconsin franchise tax. The activities performed by DEF Corporation in State Y consist of engineering services which are performed by employees of XYZ Corporation but are under the direct control of DEF Corporation. In carrying out the contracts in State Y, XYZ Corporation's employees hold themselves out to customers as the employees of DEF Corporation. DEF Corporation pays management and service fees to XYZ Corporation for the personal services of XYZ Corporation's employees in State Y. DEF Corporation has no real or tangible personal property in State Y.

Is DEF Corporation required to throw back to Wisconsin sales shipped from Wisconsin to State Y?

**Answer 2:** No. A person under the direct control of a corporation may be considered an employee for purposes of determining nexus under Public Law 86-272 even though he or she is not an employee for other purposes such as payroll taxes. The duties performed by XYZ Corporation's employees, under the direct control of DEF Corporation, are not protected by Public Law 86-272. Because XYZ Corporation employees perform services for and are under the direct control of DEF Corporation, DEF Corporation has nexus in State Y and is not required to throw back to Wisconsin those sales shipped from Wisconsin to State Y.



## SALES/USE TAXES

### 1. Advertising and Related Transactions

**Statutes:** Sections 77.52(2)(a)11 and 77.54(2), (2m), (6)(b), (15) and (25), Wis. Stats. (1989-90)

**Wis. Adm. Code:** Section Tax 11.70, July 1987 Register

**Background:** Sales of tangible personal property in Wisconsin are subject to the Wisconsin sales and use tax. Finished art sold by an advertising agency is tangible personal property and therefore is subject to the Wisconsin sales and use tax, provided a specific exemption doesn't apply. (Section Tax 11.70(2)(a), Wis. Adm. Code.)

Finished art means the final art used for actual reproduction by photomechanical or other processes, or for display purposes and includes drawings, paintings, designs, photographs, lettering, paste-ups, mechanicals or assemblies, charts, graphs, and illustrative material not reproduced.

Charges by an advertising agency for providing preliminary art prepared solely for presenting an idea to a client or prospective client is a charge for a nontaxable service. (Section Tax 11.70(1)(f), Wis. Adm. Code.)

However, if finished art or other tangible personal property is produced by the advertising agency as the result of the preliminary art work, all the charges for preliminary art are includable in the cost of finished art work and are subject to Wisconsin sales and use tax, provided a specific exemption doesn't apply.

Preliminary art work includes roughs, visualizations, sketches, layouts and comprehensives.

Several exemptions from the Wisconsin sales and use tax may apply to the sale of finished art work. These include:

1. An exemption for property that will be resold by the purchaser.
2. An exemption for printed material which is designed to advertise and promote the sale of merchandise, or to advertise the services of individual business firms, which printed material is purchased and stored for the purpose of subsequently transporting it outside Wisconsin by the purchaser for use thereafter solely outside Wisconsin. (Section 77.54(25), Wis. Stats. (1989-90).)
3. An exemption for printing or imprinting of tangible personal property which will be subsequently transported outside Wisconsin for use outside Wisconsin by the consumer for advertising purposes. (Section 77.52(2)(a)11, Wis. Stats. (1989-90).)
4. An exemption for tangible personal property becoming an ingredient or component part of an article of tangible personal property or which is consumed or destroyed or loses its identity in the manufacture of tangible personal property in any

form destined for sale. (Section 77.54(2), Wis. Stats. (1989-90).)

5. An exemption for tangible personal property or services that become an ingredient or component of shoppers guides, newspapers or periodicals or that are consumed or lose their identity in the manufacture of shoppers guides, newspapers or periodicals, whether or not the shoppers guides, newspapers or periodicals are transferred without charge to the recipient. This exemption does not apply to advertising supplements that are not newspapers. (Section 77.54(2m), Wis. Stats. (1989-90).)

For purposes of this exemption, shoppers guides, newspapers and periodicals have the meaning under sec. 77.54(15), Wis. Stats. (1989-90).

6. An exemption for containers, labels, sacks, cans, boxes, drums, bags or other packaging and shipping materials for use in packing, packaging or shipping tangible personal property, if such items are used by the purchaser to transfer merchandise to customers. Also exempt are meat casing, wrapping paper, tape, containers, labels, sacks, cans, boxes, drums, bags or other packaging and shipping materials for use in packaging, packaging or shipping meat or meat products regardless of whether such items are used to transfer merchandise to customers. (Section 77.54(6)(b), Wis. Stats. (1989-90).)

**Examples:** The following examples illustrate the Wisconsin sales and use tax application to various advertising and related transactions. All entities are located in Wisconsin unless otherwise indicated.

**Example 1:** Company A contracts with an advertising agency to produce an advertising campaign for Company A's product. The advertising agency develops 10 ideas or suggestions, in the form of preliminary art, for an advertising flyer. Company A selects one of the ideas and it is developed into finished art, which is used to produce the flyers.

The charges by the advertising agency for the production of preliminary art for all 10 ideas are subject to tax (provided an exemption doesn't apply to the sale of the finished art) because one idea was selected and was used to produce finished art.

**Example 2:** Company B contracts with an advertising agency for an ongoing advertising campaign. In February the agency submits several suggestions (in the form of preliminary art) for a spring advertising campaign. These ideas are rejected by Company B. In April the agency submits several suggestions (in the form of preliminary art) for a summer advertising campaign. One of these ideas is accepted by Company B and the advertising agency develops the preliminary art into finished art.

The charges by the advertising agency for preliminary art which was not chosen for further development (the spring advertising campaign) are not subject to tax because the preliminary art was not developed into finished art.

The charges by the advertising agency for preliminary art which was chosen for further development (the summer advertising campaign) are subject to tax (provided an exemption doesn't apply to the sale of the finished art) because the preliminary art was developed into finished art.

**Example 3:** An advertising agency presents to Company C a new sales campaign for spring fashions. A meeting is held with the Company C and the advertising agency's account executives. During the meeting, the account executives use video tape, audio briefs, roughs and visuals to present several broad avenues of media (such as print, television and radio) to Company C.

The video tapes, audio briefs, roughs and visuals are preliminary art. Company C is billed for the meeting and the bill includes a break out of the costs of the preliminary art. Company C selects an advertising campaign and the agency develops finished art.

The entire charge by the agency is subject to tax, provided an exemption doesn't apply to the sale of the finished art. The materials used to promote or advance a specific theme for Company C are preliminary art. However, since the preliminary art resulted in the production of finished art, all charges, including meeting expenses, are part of the cost of the finished art.

**Example 4:** Company D contracts with an advertising agency to produce a shoppers guide advertisement. The advertising agency produces layouts and roughs for approval by Company D. Company D approves and the finished art for the shoppers guide advertisement is produced. The preliminary art and finished art charges are billed to Company D for the job. Company D deals directly with the shoppers guide publisher to run the advertisement in a shoppers guide which meets the definition of a shoppers guide under sec. 77.54(15), Wis. Stats. (1989-90). The advertising agency bills Company D, \$1,000 for preliminary art and \$3,000 for finished art.

The total \$4,000 charged is for the production of the finished art, which is subject to Wisconsin sales tax. However, Company D can claim an exemption for the \$4,000 under sec. 77.54(2m), Wis. Stats. (1989-90), by providing the agency with a properly completed certificate of exemption (Form S-207).

Section 77.54(2m), Wis. Stats. (1989-90), provides an exemption for gross receipts from sales of tangible personal property or services that become an ingredient or component of shoppers guides, newspapers or periodicals or that are consumed or lose their identity in the manufacture of shoppers guides, newspapers or periodicals.

**Example 5:** Company E contracts with an advertising agency to have 10,000 advertising flyers produced. The advertising agency prepares preliminary art. Company E decides on one theme and the finished art is produced. The advertising agency has the flyers printed and delivered to Company E. Company E mails the flyers to their Wisconsin customers.

The object of the transaction is to obtain the flyers, therefore, the entire charge to Company E by the advertising agency, which includes the preliminary art, finished art, and the flyers, is subject to Wisconsin sales tax.

**Example 6:** Same facts as Example 5 except that the flyers are mailed to addresses outside Wisconsin.

The object of the transaction is to obtain the flyers, which occurred in Wisconsin, therefore the entire charge to Company E by the advertising agency is subject to Wisconsin sales tax. However, since the flyers were mailed outside Wisconsin, the sale is exempt under sec. 77.54(25), Wis. Stats. (1989-90). Company E may claim this exemption by providing the agency with a properly completed certificate of exemption (Form S-207).

Section 77.54(25), Wis. Stats. (1989-90), provides that the gross receipts from the sale of and the storage of printed material which is designed to advertise and promote the sale of merchandise or services is exempt from Wisconsin sales tax if the printed material is transported outside Wisconsin by the purchaser for use outside Wisconsin.

**Example 7:** Company F contracts with an advertising agency to produce an advertising flyer. The advertising agency prepares preliminary art. Company F decides on one theme and the finished art is prepared.

Company F takes the finished art to a Wisconsin printer to have 10,000 flyers produced. Company F furnished the printer with the paper on which the flyers were printed. The flyers were mailed by the printer to addresses outside Wisconsin.

The charge to Company F by the advertising agency for the preliminary art and finished art is subject to Wisconsin sales tax. Since the flyers are being given away (not sold), the exemption under sec. 77.54(2), Wis. Stats. (1989-90), doesn't apply.

The charge to Company F by the printer for the printing of the flyers is not taxable per sec. 77.52(2)(a)11, Wis. Stats. (1989-90).

Section 77.52(2)(a)11, Wis. Stats. (1989-90), provides that the charge for printing or imprinting of tangible personal property for consideration for consumers who furnish directly or indirectly the materials used in printing or imprinting are not taxable if the tangible personal property is subsequently transported outside Wisconsin for use outside Wisconsin by the consumer for advertising purposes.

**Example 8:** Company G has an advertising agency produce specification sheets for Company G's products. The specification sheets are included with the products when sold to Company G's customers. The advertising agency produces the finished art and has the printing done. Company G receives an itemized bill from the advertising agency which shows a charge for the finished art and the printing.

The object of the transaction is to obtain the specification sheets. The entire charge by the advertising agency to Company G is subject to Wisconsin sales tax. However, since the specification sheets are included with Company G's products which will be sold to its customers, Company G may claim a resale exemption for the specification sheets by providing the agency with a properly completed Wisconsin resale certificate (Form S-205).

**Example 9:** An advertising agency produces finished art to be used on Company H's shipping boxes. The boxes are used by Company H to ship its products to its customers. The advertising agency delivers the finished art to a printer who uses the finished art to print and produce the boxes which the advertising agency resells to Company H. Company H is billed \$20,000 for finished art work and \$50,000 for the boxes, totalling \$70,000 on the invoice from the advertising agency.

The object of the \$70,000 transaction is to obtain the boxes. The entire charge of \$70,000 is subject to sales tax. However, Company H may purchase the boxes (including the finished art element) exempt from sales tax under sec. 77.54(6)(b), Wis. Stats. (1989-90), by providing the agency with a properly completed certificate of exemption (Form S-207).

Section 77.54(6)(b), Wis. Stats. (1989-90), provides that containers, labels, sacks, cans, boxes, drums, bags or other packaging and shipping materials used by the purchaser in packing, packaging or shipping tangible personal property to customers are exempt from tax.

**Example 10:** Same facts as in Example 9, except that Company H purchases the finished art from the advertising agency in one transaction, delivers it to a printer/box maker who, in the second transaction, produces boxes for Company H. Company H is billed \$20,000 by the advertising agency for the finished art, and \$50,000 by the box maker for the boxes.

Each bill is for the purchase of tangible personal property and is subject to sales tax. However, Company H may purchase, by providing the agency with a properly completed certificate of exemption (Form S-207), the finished art exempt from sales tax under sec. 77.54(2), Wis. Stats. (1989-90). Company H may also purchase, by providing the printer with a properly completed certificate of exemption (Form S-207), the boxes exempt from tax under sec. 77.54(6)(b), Wis. Stats. (1989-90), as explained in Example 9.

Section 77.54(2), Wis. Stats. (1989-90), provides that the gross receipts from sales of tangible personal property which becomes an ingredient or component part of an article of tangible personal property or which is consumed or destroyed or loses its identity in the manufacturing of tangible personal property in any form destined for sale is exempt from sales tax. Since the finished art is economically destroyed in the manufacturing of the boxes, which are sold by the box maker to Company H, Company H may purchase the finished art exempt from sales tax.

**Example 11:** Company I wants advertising flyers produced. It contracts with a full service commercial printer that has its own art department. The printer's art department develops the design for the flyer, but because of its workload, subcontracts out the color separations. The color separator charges the commercial printer for the color separations. The commercial printer then prints the flyers using the color separations and its own paper and ink. Company I sends the flyers to its Wisconsin customers.

The printer's charge to Company I includes all the cost elements of the flyer, including the color separations and its own printing materials charge. This entire charge is for the advertising flyers and is subject to sales tax.

The printer may purchase, by providing the subcontractor with a properly completed manufacturer's exemption certificate (Form S-207m), the color separations exempt from sales tax under sec. 77.54(2), Wis. Stats. (1989-90).

**Example 12:** Company J wants advertising flyers produced. Company J purchases color separations from a color separator and furnishes them to a commercial printer along with the ink and paper. The flyers are printed and Company J sends the flyers to its Wisconsin customers.

Company J's purchase of the color separations is subject to sales tax. The color separations are tangible personal property. The exemption under sec. 77.54(2), Wis. Stats. (1989-90), doesn't apply since the color separations are not destroyed in the manufacture of property destined for sale (flyers are given away free of charge).

Company J's purchase of the printing service is also subject to sales tax. Since Company J is furnishing the color separations, ink and paper, the printer is providing a printing service to Company J.

Section 77.52(2)(a)11, Wis. Stats. (1989-90), provides that printing or imprinting of tangible personal property for consideration for consumers who furnish directly or indirectly the materials used in printing or imprinting is subject to the sales tax.

**Example 13:** Company K contracts with an advertising agency to produce a radio commercial. The agency produces a demonstration tape (demo) which contains several different jingles which could be used in the commercial.

Company K selects one of the jingles and the commercial is produced. The charge by the agency for the demo is subject to sales tax. The demo is preliminary art and since finished art is produced from the preliminary art, the charge is subject to sales tax under sec. Tax. 11.70(1)(f), Wis. Adm. Code, unless a specific exemption on the purchase of the radio commercial can be claimed by Company K.

**Example 14:** Company L, a producer of tapes, makes "demo" cassettes or tapes for a musician which are used by the musician as an example of the musician's composition or performance ability.

ties. The "demo" tapes are sample productions that do not require the technical resources of a recording studio.

The charge for producing the "demo" tape for the musician who will use that tape to demonstrate or promote his or her composition or performance abilities is a charge for tangible personal property and thus, subject to sales tax.

**Example 15:** Company M decides to have a radio advertising campaign and contracts with an advertising agency. The advertising agency produces several advertising jingles on a "demo" tape and Company M selects one jingle. The advertising agency then produces a master tape at its Wisconsin sound production studio. The master tape remains at the studio and 10 copies or "dubs" are produced. One dub is given to Company M and the other 9 dubs are mailed by the advertising agency directly to various Wisconsin radio stations. The air time has been arranged by Company M. The advertising agency bills Company M \$20,000 for the production of the master tape and dubs.

The entire \$20,000 is subject to sales tax because the object of the transaction is to obtain tapes to be broadcast on the radio stations.

**Example 16:** Same facts as Example 15 except that 5 of the dubs are mailed to radio stations in Illinois and Iowa.

Since 5 of the 10 dubs were delivered outside of Wisconsin, the gross receipts from the sale of those dubs is not subject to Wisconsin sales tax. Therefore, only one-half of the \$20,000, which represents the 5 dubs used in Wisconsin, is subject to the sales tax.

**Example 17:** A Wisconsin television station produces a commercial tape for Company N. The master tape remains at the TV station in Wisconsin. Copies of the commercial (dubs) are sent by the TV station to various other television stations in Wisconsin at the direction of Company N. The TV station bills Company N for producing the commercial tape plus air time to run the commercial. The itemized bill shows \$1,000 for charges related to the production and \$5,000 for the air time.

The object of this transaction is two-fold. One object is to obtain tangible personal property (master and dubs) and the other is to obtain TV air time.

The \$1,000 charge related to the production of the tapes is subject to sales tax. The \$5,000 charge for air time is not subject to sales tax.



## 2. Charge for Disposal of Tangible Personal Property

**Statutes:** Sections 77.51(4)(c)2 and 77.52(1) and (2)(a), Wis. Stats. (1989-90)

**Wis. Adm. Code:** Section Tax 11.32(2), April 1990 Register

**Facts and Question 1:** Customer A wants to dispose of old tires. For a fee of \$10, Retailer B agrees to take the old tires and deliver them to a local landfill where they will be picked up by a manufacturer which will use them as fuel in its manufacturing operation.

Is the charge to Customer A for the disposal of the tires subject to Wisconsin sales tax?

**Answer 1:** No. Retailer B is providing a service that is not subject to sales tax under sec. 77.52(2)(a), Wis. Stats. (1989-90).

**Facts and Question 2:** Customer A purchases new tires from Retailer B. Retailer B removes the old tires from Customer A's vehicle and installs the new tires. Retailer B agrees to dispose of the old tires for Customer A for an additional charge. The invoice to Customer A includes the following:

Sale and installation of new tires and disposal of old tires	\$150
---	-------

Is the entire \$150 charge to Customer A subject to Wisconsin sales tax?

**Answer 2:** Yes. The entire charge of \$150 to Customer A is subject to sales tax. Section Tax 11.32(2), Wis. Adm. Code, provides that a retailer's gross receipts from charges for handling or other services (e.g., disposal of tires) related to retail sales shall be included in gross receipts derived from the sale of tangible personal property or taxable services.

**Facts and Question 3:** Assume the same facts as in Facts and Question 2 except that the invoice to Customer A reads as follows:

Sales price of new tires	\$100
Labor to install new tires	40
Charge to dispose of old tires	10
Total	\$150

Is the entire \$150 charge to Customer A subject to Wisconsin sales tax?

**Answer 3:** Yes. The entire charge is included in Retailer B's gross receipts for purposes of imposing Wisconsin sales tax under sec. Tax 11.32, Wis. Adm. Code, even though the disposal fee is separately stated.

**Facts and Question 4:** Retailer A is a plumbing contractor. Customer C contracts with Retailer A to install a new water heater at his residence. Retailer A will also remove the old water heater for a charge of \$25. The invoice to Customer C reads as follows:

Sale of new water heater	\$300
Installation	100
Disposal of old water heater	25
Total	\$425

Is any of the charge to Customer C subject to Wisconsin sales tax?

**Answer 4:** No. The charge to Customer C is not subject to Wisconsin sales tax. Retailer A is providing a real property improvement which is not subject to tax. The disposal fee is not subject to tax because it does not relate to the sale of tangible personal property as required by sec. Tax 11.32(2), Wis. Adm. Code.

**Facts and Question 5:** Retailer E is in the business of selling and installing washers and dryers. Customer F purchases a washer and dryer from Retailer E and has Retailer E hook them up in his home. Customer F agrees to pay an additional amount to Retailer E for disposal of his old washer and dryer. The invoice to Customer F reads as follows:

Sale of washer and dryer	\$800
Installation	50
Disposal of old washer and dryer	50
Total	\$900

Is the entire \$900 charge to Customer F subject to Wisconsin sales tax?

**Answer 5:** Yes. The \$900 charge to Customer F is subject to Wisconsin sales tax. Retailer F is selling tangible personal property which is subject to tax. Any handling charge (i.e., disposal of old washer and dryer) associated with the sale of tangible personal property is also subject to sales tax under sec. Tax 11.32(2), Wis. Adm. Code.



### 3. Donation vs. Sale at Retail

**Statutes:** Sections 77.51(4)(a)(intro.) and (14)(b) and 77.52(1), Wis. Stats. (1989-90)

**Wis. Adm. Code:** Section Tax 11.65(4), July 1987 Register

**Note:** For purposes of this Tax Release, it is assumed that the organization does not qualify for the occasional sales exemption under sec. 77.54(7m), Wis. Stats. (1989-90).

**Background:** For the privilege of selling tangible personal property at retail, a tax is imposed upon all retailers at a rate of 5% of the gross receipts from the sale of tangible personal property in this state.

Section 77.51(14)(b), Wis. Stats. (1989-90), provides that a sale at retail includes the furnishing or distributing of tangible personal property for a consideration by a social club or fraternal organization to its members or others.

Section 77.51(4)(a)(intro.), Wis. Stats. (1989-90), provides that gross receipts means the total amount of the sale from a sale at retail of tangible personal property or taxable services, valued in money, whether received in money or otherwise.

Section Tax 11.65(4)(a), Wis. Adm. Code, provides that receipts are not taxable if they are donations. To qualify as a donation, a payment must be totally voluntary and no restriction whatsoever may be placed on the person making the donation.

Section Tax 11.65(4)(b), Wis. Adm. Code, provides that when a charge to a patron bears little or no relationship to the actual value received, the tax may be based on reasonable value of the tangible personal property and taxable services received.

**Facts and Question 1:** A nonprofit organization distributes coats to persons in need. The person who receives the coat may make a donation to the nonprofit organization for the coat, although a donation is not required.

Are the gross receipts from the donations for the coats subject to Wisconsin sales tax?

**Answer 1:** No. The transfer of the coat for the donation is not considered a sale at retail for purposes of imposing Wisconsin sales or use tax because the decision to make the donation is totally voluntary and there are no restrictions placed on the person making the donation.

**Facts and Question 2:** A nonprofit organization places boxes of candy bars in numerous establishments throughout the state. To obtain a candy bar, a customer is required to make a donation of 50 cents to the nonprofit organization. The fair market value of the candy bar is 50 cents.

Are the gross receipts from the donations for candy bars (50 cents per candy bar) subject to Wisconsin sales tax?

**Answer 2:** Yes. The transfer of a candy bar for a required donation is a sale for purposes of imposing Wisconsin sales tax. Gross receipts for purposes of imposing Wisconsin sales tax are 50 cents per candy bar, the reasonable value of the tangible personal property received.

**Facts and Question 3:** A nonprofit organization sponsors a dinner for which the required donation is \$175 a plate. The fair market value of the dinner is \$10.

Are gross receipts from the required donation (\$175 per plate) subject to Wisconsin sales or use tax?

**Answer 3:** Only \$10 of the \$175 required donation is considered gross receipts subject to Wisconsin sales tax. Gross receipts for purposes of imposing Wisconsin sales or use tax is the reasonable value of the tangible personal property received by the customer.

**Facts and Question 4:** A veteran's group (nonprofit organization) locates various members of its organization at local retail establishments. The member gives a poppy to every person leaving the retail establishment. Those persons receiving a poppy may make a donation, but are not required to do so.

Are gross receipts from the donations received by the veteran's group subject to Wisconsin sales or use tax?

**Answer 4:** No. The transfer of the poppy for a voluntary donation is not a sale subject to Wisconsin sales tax.



#### 4. Municipal Water Softener

**Statutes:** Sections 77.51(2), 77.52(1), and 77.54(9a), Wis. Stats. (1989-90)

**Wis. Adm. Code:** Sections Tax 11.68, April 1990 Register and Tax 11.86, September 1984 Register

**Background:** Contractors who perform real property construction activities for governmental units or other exempt entities are the consumers of material used in the real property construction project. The contractor must pay sales or use tax on the cost of materials so used. The governmental units' exempt status does not pass through to the contractor's purchase of these materials.

Contractors' sales of items to exempt entities which retain their character as tangible personal property after installation are exempt under sec. 77.54(9a), Wis. Stats.

**Facts and Question:** A city water utility installs an iron-magnesium removal system into the municipal water system. The iron-magnesium removal system equipment will be installed in the pumphouse at the municipal well. The system is comprised of 2 chemical pre-treatment tanks approximately 6' high and 10' in diameter. The filtration system is 78" high.

Water from the well is pumped to the pre-treatment tanks, into the filtration system for treatment, then piped to the reservoir.

Does the iron-magnesium removal system become a real property improvement or retain its character as tangible personal property after installation?

**Answer:** Because the system processes water for sale, the iron-magnesium removal system retains its character as tangible personal property after installation. The city may purchase the installed system exempt from sales tax under sec. 77.54(9a), Wis. Stats.



#### 5. Sales and Purchases by Federal Credit Unions

**Statutes:** Sections 77.54(1) and 77.55(1), Wis. Stats. (1989-90)

**Wis. Adm. Code:** Section Tax 11.69(5), January 1983 Register

**Background:** Section 77.54(1), Wis. Stats. (1989-90), provides that Wisconsin may not tax the sale of and the storage, use, or other consumption in Wisconsin of tangible personal property and services it is prohibited from taxing under the Constitution or laws of the United States.

Section 77.55(1), Wis. Stats. (1989-90), provides an exemption from Wisconsin sales tax for gross receipts from the sale of tangible personal property or taxable services to the United States, its unincorporated agencies and instrumentalities, and any incorporated agency or instrumentality of the United States wholly owned by the United States or by a corporation wholly owned by the United States.

Section 1768 of the United States Code, Title 12, provides that federal credit unions shall be exempt from all taxation imposed by the United States or by any state, territorial, or local taxing authority, except that any real property and any tangible personal property of a federal credit union shall be subject to federal, state, territorial, and local taxation to the same extent as other similar property is taxed. However, the duty or burden of collecting or enforcing the payment of a tax shall not be imposed upon a federal credit union and the tax shall not exceed the rate of taxes imposed upon the holdings in a domestic credit union.

**Question 1:** Are gross receipts from sales of tangible personal property and taxable services by federal credit unions subject to Wisconsin sales tax?

**Answer 1:** Yes. Gross receipts from retail sales of tangible personal property and taxable services by a federal credit union are subject to sales tax.

The exemption under sec. 77.54(1), Wis. Stats. (1989-90), does not apply because 12 USCS § 1768, does not prohibit a state from taxing sales of tangible personal property by federal credit unions where the incidence of tax does not fall upon the federal credit union (i.e., the incidence of tax falls upon the customer of the federal credit union).

The following are examples of taxable tangible property sold by federal credit unions which are subject to Wisconsin sales tax:

- A. Personalized imprinted checks.
- B. Collector's coins or currency sold at above face value.
- C. Commemorative metals and coin banks.
- D. Gold and silver bullion.
- E. Repossessed merchandise.

**Question 2:** Are purchases of tangible personal property and taxable services by federal credit unions subject to Wisconsin sales or use tax?

**Answer 2:** No. Purchases by federal credit unions of tangible personal property and taxable services used in the conduct of their trade or business as a federal credit union are not subject to Wisconsin sales or use tax.

With respect to purchases, the incidence of tax falls upon federal credit unions as purchasers which is prohibited under 12 USCS § 1768, and, therefore, exempt under sec. 77.54(1), Wis. Stats. (1989-90).

To relieve itself from liability for sales and use tax on sales to a federal credit union, a retailer selling tangible personal property or taxable services to a federal credit union should keep a copy of the purchase order clearly identifying the federal credit union as the purchaser.



## 6. Services Performed on Utility Right-of-Way

Statutes: Section 77.52(2)(a)20, Wis. Stats. (1989-90)

Wis. Adm. Code: Section Tax 11.86, September 1984 Register

Background: In the Tax Release titled "Tree Trimming on a Utility's Right-of-Way" in *Wisconsin Tax Bulletin* #57, July 1988, it was determined that gross receipts from tree trimming on a utility's right-of-way was not a taxable landscaping service under sec. 77.52(2)(a)20, Wis. Stats., pursuant to the Wisconsin Tax Appeals Commission decision of June 19, 1987, as modified by the Dane County Circuit Court stipulation and order dated September 21, 1987, in *Capital City Tree Experts, Inc. vs. Wisconsin Department of Revenue*.

Facts and Question 1: A contractor is hired by a utility to spray trees and shrubs on its right-of-way to prevent interference with overhead distribution lines or make distribution lines inaccessible to children.

Are the gross receipts from spraying trees or shrubs on a utility's right-of-way subject to Wisconsin sales or use tax?

Answer 1: No. Gross receipts from spraying trees and shrubs on a utility's right-of-way is not a taxable service under sec. 77.52(2)(a)20, Wis. Stats. (1989-90), pursuant to the *Capital City Tree Experts, Inc.* decision.

Facts and Question 2: After installing underground transmission and distribution lines in a new subdivision, a utility retained the services of a contractor to restore the land around the lines by filling in low areas with topsoil and laying sod.

Is the charge by the contractor to the utility subject to Wisconsin sales and use tax?

Answer 2: Yes. This is a taxable landscaping service under sec. 77.52(2)(a)20, Wis. Stats. (1989-90). The primary purpose of obtaining the service is to change the appearance of the area around the transmission and distribution lines. The *Capital City Tree Experts, Inc.* decision does not apply because the service is

not performed to prevent interference with overhead distribution lines or to make the lines inaccessible to children.



## 7. Taxability of Computer Software

Statutes: Sections 77.51(14)(h) and (j) and 77.52(1) and (2)(a)10, Wis. Stats. (1989-90)

Wis. Adm. Code: Section Tax 11.71, February 1986 Register

Background: Section Tax 11.71(2)(b), Wis. Adm. Code, provides that the retail sale, lease, rental, or license to use prewritten programs ("canned software") and basic operational programs, including the maintenance and enhancement of those programs are subject to Wisconsin sales or use tax.

Section Tax 11.71(3)(b), Wis. Adm. Code, provides that the providing of custom programs is not subject to Wisconsin sales or use tax. Custom programs are utility and application software which accommodate the special processing needs of the customer.

In a decision dated June 23, 1988, the Wisconsin Court of Appeals, District IV, held in the case of *Wisconsin Department of Revenue v. International Business Machines Corporation*, that revenues from the license of made-to-order computer programs to Wisconsin customers were not subject to sales tax. The department appealed this decision to the Wisconsin Supreme Court but the petition for review was denied.

In a decision dated May 23, 1989, the Wisconsin Tax Appeals Commission held in the case of *Health Micro Data Systems, Inc. vs. Wisconsin Department of Revenue*, that the taxpayer was a manufacturer of tangible personal property and, therefore, machinery and equipment it used in producing computer programs were not subject to Wisconsin sales or use tax. The computer programs were not modified for specific users. All were prewritten and needed little or no manufacturer assistance after installation. The department filed a notice of nonacquiescence with respect to this decision on an issue not relevant to this tax release.

The following facts and questions illustrate the department's position with respect to the taxability of computer software transactions it has reviewed in light of the *IBM* and *Health Micro Data* decisions.

Facts and Question 1: Vendor SV-1, a Wisconsin-based company, sells computer systems for manufacturers and distributors. Vendor SV-1 sells both the hardware and software to a customer. The base price of the software is \$20,000. The software is purchased independent of the hardware.

Other pertinent facts regarding Vendor SV-1 include:



- a. Prior to a sale, Vendor SV-1 personnel spend 40 to 60 hours in meetings with the customer to determine the needs of the customer.
- b. The systems sold are made up of several modules (programs). Each module requires some modification. A minor modification might require adding another field or changing the length of a field. A major modification might require changing the method of computing discounts. Major modifications take 160 person-hours or more.
- c. Vendor SV-1 will install and test the software on a customer's system which normally takes 20 to 40 hours.
- d. Training is available and strongly recommended to customers.
- e. Documentation provided to each customer includes a reference manual and actual source code (the programs). The documentation is customized for each system.
- f. Vendor SV-1 provides modifications to the software as its principal form of maintenance. A modem is set up to enable Vendor SV-1's computer to talk with the customer's computer. When a problem is encountered the customer contacts Vendor SV-1 via a hotline. A Vendor SV-1 technician sitting at a computer in Milwaukee can make changes to the customer's program, compile it, test it and have it ready for the customer without leaving his or her desk. Telephone support constitutes 98% of the support provided.
- g. Software upgrades are made periodically. These upgrades are purchased separately, usually at 10% of the current list price.
- h. Professional services, including consulting, installing, training, modifications, and initial maintenance are billed separately.

Are the programs and maintenance provided by Vendor SV-1 subject to Wisconsin sales or use tax?

Answer 1: No. The programs being sold by Vendor SV-1 are custom programs and are not subject to Wisconsin sales or use tax for the following reasons:

- a. Significant modifications are being made to virtually all programs to meet the specific needs of an individual customer.
- b. The extent of useful enhancements and maintenance support far exceed that which would be required for canned programs.

However, any charges for computer hardware are taxable.

Facts and Question 2: Vendor SV-2 sells software to Customer A (an accounting firm) for \$65,000. Other facts include:

- a. The software is a time/billing package used to track accountants' time and generate billings to clients.

- b. The programs are changed to meet the needs of Customer A. Modules are changed to customize matter numbers, change field formats, customize timekeeper numbers, customize account numbers, and provide additional reports.
- c. Changes are also made to conform the programs to Customer A's operating environment. Interfaces to other software packages have been created. The software has been changed to accommodate Customer A's printing capabilities.
- d. The programs are loaded onto Customer A's system by Vendor SV-2, with the actual code transferred by magnetic tape.
- e. Maintenance "fixes" are released as necessary. Enhancements are released on a quarterly or semi-annual basis.

Is Customer A subject to sales or use tax on the programs and maintenance service it purchases from Vendor SV-2?

Answer 2: No. This transaction is considered to be a sale of custom software which is not subject to Wisconsin sales or use tax for the following reasons:

- a. The software purchased by Customer A is unique as compared to any other system sold by Vendor SV-2.
- b. Modifications are made to the time and billing programs and other support programs based on the particular needs and system requirements of Customer A.

Since the software is not subject to tax, the maintenance service to the software is not a service which is subject to tax under sec. 77.52(2)(a)10, Wis. Stats. (1989-90).

Facts and Question 3: Vendor SV-3 sells a data entry program to Customer B. The sales price of the program is \$25,000. Other information regarding the data entry program sold to Customer B includes:

- a. Vendor SV-3 will discuss operational environment, types of software and hardware with the customer, and current data entry methods. This involves telephone conferences and may involve on-site visits.
- b. Pre-existing programs are modified to adjust for Customer B's current operating system. This is done by running several small programs (macros) which modify the existing modules.
- c. Customer B can make specific modifications to add programs to the basic system.
- d. The program can be transmitted by any magnetic media or by phone, but is usually transferred by magnetic tape.
- e. Customer B installs the software per Vendor SV-3's written instructions. Phone assistance is provided if needed.

- f. Maintenance is performed continuously. Enhancements are provided annually.

Is the sale of this software by Vendor SV-3 to Customer B subject to Wisconsin sales or use tax?

**Answer 3:** No. The software sold by Vendor SV-3 is not a "canned" program. Based on the decision in *IBM*, it is not subject to Wisconsin sales or use tax for the following reasons:

- a. The program, as ordered by Customer B, does not exist prior to the time Customer B orders it.
- b. Vendor SV-3 analyzes Customer B's environment and fills the order by tailoring existing modules to fit this environment.
- c. Maintenance to the programs is continuous, which is a trait of a custom program.

**Facts and Question 4:** Customer C bought a spreadsheet program for \$400 for use on its personal computer (PC). The software comes in a shrink-wrapped package and is available from many vendors.

Customer C's personnel installed the software on the PC. An installation program prompted the user for information such as type of monitor, type of printer and default drive.

Customer C's personnel took a course on how to use this program. In addition, several employees of Customer C spent in excess of 100 hours writing macros and designing templates which are being used in conjunction with the program for budgeting, accounts receivable aging, inventory tracking, and other functions.

Is the sale of this computer program for \$400 to Customer C subject to Wisconsin sales or use tax?

**Answer 4:** Yes. The spreadsheet program is "canned" software, the sale of which is subject to Wisconsin sales or use tax for the following reasons:

- a. The individual needs of Customer C were not considered in the design of the software.
- b. The program existed at the time Customer C purchased the software.
- c. The vendor makes no changes to the software because of Customer C's computer environment.

The work done by Customer C's employees does not impact on the nature of the software. Any customizing, other than changes made by the vendor prior to the sale, does not effect the taxability of the sale.

**Facts and Question 5:** Vendor SV-4 sells utility software, which captures and archives messages as jobs are run on mainframe

computers. The prospective customer contacts Vendor SV-4, usually after reviewing a brochure or trade magazine. Other pertinent facts regarding this software include:

- a. The programs exist at the time a customer places an order and modifications are not made to any programs prior to the shipment of the program to the customer.
- b. Programs are transferred to the customer on magnetic tape.
- c. The programs are loaded, installed, and tested by the customer.
- d. The program is licensed annually. Maintenance and enhancements are included in the license fee.
- e. A customer may modify the program ; however, modification to the object code (the program itself) voids the warranty.
- f. Corrections to the program are released as needed, usually every six months. Enhancements are issued about once a year.

Is the sale of the utility software by Vendor SV-4 subject to Wisconsin sales or use tax?

**Answer 5:** Yes. Vendor SV-4 is selling "canned" software which is subject to Wisconsin sales or use tax because the software exists at the time an order is placed and no changes are made to tailor the program to a customer's needs.

**Facts and Question 6:** Customer D contracts with Vendor SV-5 to obtain new computer software for use on its mainframe computer. Included in the licensing agreement is software which will assist in the following areas:

- a. Order entry and billing.
- b. Accounts receivable.
- c. Purchasing.
- d. Accounts payable.
- e. General ledger.
- f. Financial reporting and budgeting.
- g. Inventory control.
- h. Product structure.
- i. Materials planning.
- j. Production scheduling.
- k. Product standard costing.
- l. Shop floor control.
- m. Capacity planning.

After an extensive review by Customer D and a professional consultant (Consultant E) of products on the market, Customer D purchases software from Vendor SV-5 for \$100,000.

Additional facts regarding this software are as follows:

- a. The software purchased existed at the time Customer D placed the order. Vendor SV-5 did not change the pre-existing pro-

grams based on Customer D's data or specific hardware or software environment.

- b. The software was shipped to Customer D via magnetic tape.
- c. In order to make the software useful to Customer D, extensive modifications were necessary. Customer D did not employ Vendor SV-5 to install and modify the program. Instead, the testing and installation were initially completed by Consultant E.
- d. Consultant E had difficulties in modifying the software to make it operational. After one year, only two of the modules were operational and the service contract with Consultant E was terminated.
- e. After another unsuccessful attempt to get the system operational using another consulting company, Vendor SV-5 was hired to modify the software to make it operational. This occurred two years after the original sale.

Is the sale of this software for \$100,000 subject to Wisconsin sales or use tax?

**Answer 6:** Yes. The software originally sold by Vendor SV-5 to Customer D for \$100,000 is "canned" software. The sale of this software is subject to Wisconsin sales or use tax for the following reasons:

- a. Vendor SV-5 sold pre-written programs "as is".
- b. No changes were made to tailor the programs to Customer D's data or hardware or software environment.

Modifications made by Customer D or other third parties, subsequent to the initial sale, do not impact on the determination of taxability at the time of sale.

**Facts and Question 7:** What is the tax status of "system software"?

**Answer 7:** Section Tax 11.71(1)(c), Wis. Adm. Code, defines "system software" to mean "programs that perform the overall control and direction of a computer, and permit it to execute the instructions contained in utility software and applications software programs."

If system software is not accessible or modifiable by the end user, the software is considered to be part of the hardware. As such, it would be considered tangible personal property, the sale of which is subject to Wisconsin sales or use tax.



## 8. Tire Fee on New Vehicles

**Statutes:** Section 77.51(4)(a), Wis. Stats. (1989-90)

**Wis. Adm. Code:** Section Tax 11.26(1), April 1990 Register

**Background:** Section 77.51(4)(a), Wis. Stats. (1989-90), defines "gross receipts" to mean the total amount of the sale, lease or rental price from sales at retail of tangible personal property or taxable services, valued in money, whether received in money or otherwise, without any deduction on account of any tax included in or added to the purchase price. Gross receipts do not include any tax imposed by the United States, this state, or any municipality of this state upon or with respect to retail sales whether imposed upon the retailer or the consumer if measured by a state percentage of sales price or gross receipts.

**Facts and Question:** Section 342.14(1m), Wis. Stats. (1989-90), imposes a \$2 tire recovery fee for each tire, including spare tires, on a new motor vehicle upon the filing of an application for first certificate of title. The fee is paid to the Wisconsin Department of Transportation.

Is this tire recovery fee included in gross receipts of a sale of a new motor vehicle for purposes of imposing Wisconsin sales or use tax? For example, if a new vehicle is purchased for \$15,000, is sales tax imposed on \$15,000 or \$15,010 (the \$15,000 purchase price of the vehicle, plus the \$10 tire recovery fee for 5 tires)?

**Answer:** The Wisconsin sales tax is imposed on the \$15,000 purchase price of the vehicle. The \$10 tire recovery fee is not included in gross receipts under sec. 77.51(4)(a), Wis. Stats. (1989-90).



## 9. Trade-In of Solely-Owned and Leased Automobiles

**Statutes:** Section 77.51(4)(b)3, Wis. Stats. (1989-90)

**Background:** Section 77.51(4)(b)3, Wis. Stats. (1989-90), states "In all transactions in which an article of tangible personal property is traded toward the purchase of an article of greater value, the gross receipts shall be only that portion of the purchase price represented by the difference between the full purchase price of the article of greater value and the amount allowed for the article traded."

When a customer offers to "trade in" a leased vehicle towards the purchase of another vehicle, the automobile dealer usually contacts the third party lessor to determine the buy out value of the lease. This value is taken into account in negotiating the price of the vehicle the customer wishes to purchase from the automobile dealer. If the deal is consummated, the dealer sells a vehicle to the customer and purchases the leased vehicle from the third party lessor.

**Facts and Question 1:** An automobile dealer sells Customer A an automobile having a selling price of \$18,000 in exchange for Customer A's solely-owned vehicle and \$14,000 cash.

What are the automobile dealer's gross receipts for purposes of imposing sales tax?

**Answer 1:** The dealer's gross receipts are \$14,000, which is the \$18,000 selling price less the trade-in of \$4,000.

**Facts and Question 2:** Customer B is leasing an automobile from a leasing company. Customer B enters into an agreement to purchase a new vehicle from an automobile dealer for a selling price of \$18,000. The dealer agrees to take possession of Customer B's leased vehicle by paying the leasing company the \$6,000 still due on the leased vehicle. The value of the leased vehicle is \$5,000.

What are the automobile dealer's gross receipts on the sale of the automobile to Customer B for purposes of imposing sales tax, and what are the dealer's sales tax obligations with respect to the leased vehicle?

**Answer 2:** This sale involves two transactions. With respect to the first transaction involving the sale of the automobile by the dealer to Customer B, the dealer should collect from the customer Wisconsin sales tax and, if applicable, county sales or use tax, based on gross receipts of \$18,000. Section 77.51(4)(b)3, Wis. Stats. (1989-90), which allows for the reduction of gross receipts by the amount of a "trade-in," does not apply to this sale because the purchaser (Customer B) does not own the leased automobile. The sale of the vehicle to Customer B by the automobile dealer is a separate transaction from the dealer's purchase of Customer B's old vehicle from the leasing company.

With respect to the second transaction, involving the sale of the leased vehicle by the leasing company to the dealer, if this vehicle is being purchased for resale by the dealer, the dealer should provide the leasing company with a properly completed resale certificate to exempt this sale from sales tax. If the vehicle is not purchased by the dealer for resale, the sale is subject to Wisconsin sales tax and, if applicable, county sales or use tax based on the buy out price of \$6,000.



## 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 "W" is for "Wisconsin", the first two digits are the year the ruling becomes available for publication (80 days after the ruling is issued to the taxpayer), the next two digits are the week of the year, and the last three digits are the number in the series of rulings issued that year. The date following the 7-digit number is the date the ruling was mailed to the requestor.*

*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 Wisconsin Department of Revenue," contains additional information about private letter rulings.*

The following rulings are included:

**W9106001, November 15, 1990**

**NOTE:** This private letter ruling was previously published in *Wisconsin Tax Bulletin* 71, p. 20. It is being published again in its entirety to correct an error that appeared in the analysis. The analysis had stated that providing storage for a motor vehicle was subject to sales tax. Providing storage space for a motor vehicle is not subject to sales tax.

**Type Tax:** Sales/Use

**Statutes:** Sections 77.51(20) and 77.52(1) and (2)(a)2 and 9, Wis. Stats. (1987-88)

**Issue:** Mobile home lot rental

This letter responds to your request for a private letter ruling regarding the rental of mobile home lots for Wisconsin sales and use tax purposes.

**Facts**

You own a mobile home. You rent a lot on which your mobile home is affixed in a mobile home park. The mobile home is permanently affixed to the land and is connected to utilities. The rental of the lot includes water and sewer services. No other services or facilities are provided (i.e., electricity, garbage removal, clubhouse, pier, raft, pool, laundry room, picnic tables, playground, or other improvements).

**Ruling Request**

You ask whether the rental of the mobile home lot is subject to Wisconsin sales tax.

**Ruling**

The gross receipts from the rental of mobile home lots, which are not part of a campground facility that offers others services or facilities, are not subject to Wisconsin sales tax.

**Analysis**

Section 77.52(1), Wis. Stats. (1987-88), provides that a sales tax shall be imposed on the gross receipts from the lease or rental of tangible personal property at retail in Wisconsin. Section 77.51(20), Wis. Stats. (1987-88), defines "tangible personal property" to mean all tangible personal property of every kind and description. Land is commonly known to be real property.

Section 77.52(2)(a)2, Wis. Stats. (1987-88), imposes a sales tax on the sale of admissions to amusement, athletic, entertainment or recreational events or places (such as a campground).

Section 77.52(2)(a)9, Wis. Stats. (1987-88), provides that parking for motor vehicles is subject to sales tax. Motor vehicle is defined in sec. Tax 11.83(1), Wis. Adm. Code, as a self-propelled vehicle designed for and capable of transporting persons or property on a highway.

Because the rental of the lot in question is the rental of real property, rather than tangible personal property, sec 77.52(1), Wis. Stats. (1987-88), does not apply. Because the fee paid to the mobile home park owner is for rent only and not for recreational services or facilities, sec. 77.52(2)(a)2, Wis. Stats. (1987-88), does not apply. Because the mobile home in question is not a motor vehicle, as defined in sec. Tax 11.83(1), Wis. Adm. Code, sec. 77.52(2)(a)9, Wis. Stats. (1987-88), does not apply. Therefore, the rental of your mobile home lot is not subject to Wisconsin sales tax.



W9116002, January 24, 1991

Type Tax: Sales/Use

Statutes: Section 77.54(20)(c)1 and 6, Wis. Stats. (1989-90)

Issue: Exemptions — baked goods consumed off premises

This letter responds to your request for a Private Letter Ruling regarding the sales and use tax status of various sales of baked goods.

#### Facts

1. Company A is a retailer which sells muffins, cookies and brownies (baked goods) as its primary products.
2. Generally speaking, Company A leases space in enclosed shopping malls for their retail outlets. There are no facilities provided by Company A for seating or food consumption on the leased premises. The lease contracts restrict the sale of all food products in a "to go" or "take out" basis.
3. Depending on the quantity purchased, the product will be enclosed in decorative metal tins, large paper bags, or wrapped in small paper bags.
4. Sales of the baked goods may be made in any quantity. However, the actual sales price of the product is determined by the weight of the product sold, not by the quantity of pieces (i.e., the sales price of a dozen cookies will vary from transaction to transaction as the weight of the cookies varies).

5. Prices of the baked goods runs from \$7.49 to \$7.99 per pound. There are approximately nine (9) baked goods per pound.
6. The baked goods are not intended to be sold in a "heated" state. They are heated when prepared, but not necessarily prepared to be sold "heated."
7. The following six transaction scenarios are common in the day to day operations of Company A:
  - a. A customer purchases one (1) baked good. After the sale is finalized, the customer proceeds to take the item out of the packaging and consumes the item as he/she is walking away from the store. Thus, the item is eaten in the mall corridor, at the common area benches or in another retail outlet. The average price of one (1) baked good is 86¢.
  - b. A customer purchases three (3) baked goods. After the sale is finalized the customer proceeds to take one item out of the packaging and consume the item as he/she is walking away from the store. Thus, the item is eaten in the mall corridor, at the common area benches or in another retail outlet. The average price of three (3) baked goods is \$2.58.
  - c. A customer purchases six (6) or more baked goods. After the sale is finalized, the customer proceeds to take one item out of the packaging and consumes the item as he/she is walking away from the store. Thus, the item is eaten in the mall corridor, at the common area benches or in another retail outlet. The average price of six (6) baked goods is \$5.16.
  - d. A customer purchases one (1) baked good. Company A does not know whether the item is to be consumed in the enclosed mall or consumed elsewhere.
  - e. A customer purchases three (3) baked goods. Company A does not know if any of the items are to be consumed in the enclosed mall or consumed elsewhere.
  - f. A customer purchases six (6) or more baked goods. Company A does not know if any of the items are to be consumed in the enclosed mall or consumed elsewhere.

#### Request

Based on the foregoing, a ruling is requested that, for state sales tax purposes, determines whether any or all of the six specific transactions listed above are subject to sales tax in Wisconsin under sec. 77.54(20), Wis. Stats.

#### Ruling

The sale of baked goods for "on-premises" consumption is subject to sales and use tax. "Premises" is to be broadly construed and includes the common areas inside a shopping mall. Thus, the sale of baked goods which will be consumed in the common areas of

the mall are subject to sales and use tax. For purposes of this ruling, common areas of the mall are all areas within the mall which are for use by the patrons of any of the retailers located in the mall, including hallways, walkways, benches, rest areas and "food courts" (areas where tables and chairs are provided).

Under the circumstances of the sales as described, a determination by Company A must be made as to when baked goods will be consumed in the common areas of the mall. Several suggested methods of accomplishing this are discussed in the following analysis, however, any method that produces a reasonable result is acceptable.

### Analysis

The first issue to resolve is what constitutes the "premises" of Company A. Section 77.54(20)(c)1, Wis. Stats., states;

"The gross receipts from sales of meals, food, food products and beverages sold by any person, organization or establishment for direct consumption on the premises are taxable ..."

Section 77.54(20)(c)6, Wis. Stats., provides that:

"For purposes of subd. 1, "premises" shall be construed broadly, and, by way of illustration but not limitation, shall include the lobby, aisles and auditorium of a theater or the seating, aisles and parking area of an arena, rink or stadium or the parking area of a drive-in or outdoor theater. The premises of a caterer with respect to catered meals or beverages shall be the place where served. Vending machine premises shall include the room or area in which located."

First, "premises" is to be broadly construed, and second, with a review of the examples included in the statute, the "premises" of a proprietor include areas which may not be leased or owned by the proprietor, or even under the proprietor's control, nor for exclusive use of the proprietor.

This interpretation is consistent with the position in sec. Tax 11.51(1), Wis. Adm. Code, that the sales and use tax exemption for "food, food products and beverages" found in sec. 77.54(20), Wis. Stats., "... generally exempts all basic food items ... necessary for the home preparation of meals." Bakery items consumed in common areas of the mall are clearly not used in the home preparation of meals.

Given the fact that baked goods sold and consumed in the common areas of the mall are subject to tax; how does Company A determine when baked goods will be consumed in the common areas of the mall?

Any method that Company A chooses that produces a reasonable result would be acceptable.

Suggested methods include:

(a) Asking each patron (before explaining the tax ramifications) if the product will be consumed in the mall or at home. It may be assumed that any bakery product sold not in a bag, but rather in a tissue, will be consumed in the common area of the mall. (The reverse would not necessarily be true.)

(b) A survey of patrons could be conducted and tax reported by Company A based on the results of the survey.

These are only suggested methods of determining on premises consumption. Again, any method that produces a reasonably accurate result would be acceptable.



W9117003, February 5, 1991

Type Tax: Sales/Use

Statutes: Sections 77.51(14)(intro.), 77.52(2)(a)5, (13), and (14), and 77.59(4), Wis. Stats. (1987-88)

Issue: Exemptions — transportation service

This is in response to your request for a Private Letter Ruling concerning chauffeured limousine services.

### Facts

Corporation B currently operates and has operated a chauffeured limousine service since June 1988. It has collected and remitted sales tax on its gross receipts from its services since that time.

Corporation B's limousine service consists of one stretched limousine that is provided to the general public complete with a licensed chauffeur for a specified date and time. The corporation owns the limousine and employs chauffeurs to drive the vehicle.

Corporation B's charge to the customer for the limousine is generally structured in one of three different ways:

- 1) A flat hourly fee, for example \$40.00 per hour.
- 2) A fixed rate for a particular destination, for example, \$115.00 one way to O'Hare Airport in Chicago, or \$60.00 one way to Madison, Wisconsin.
- 3) As part of a package, including dinner for two at a restaurant and the limousine ride to and from the restaurant for a fixed package price of \$79.95 Sunday through Thursday or \$99.95 Friday or Saturday.

The stated prices do not include the tip to the chauffeur or use of the cellular phone at the rate of \$1.00 per minute.

Bottles of champagne are available for an additional charge.

## Request

Corporation B requests a ruling as to the sales and use taxability of providing this service/rental. In addition, if this is a nontaxable service may Corporation B file a claim for refund for sales taxes paid on this service since its inception in 1988.

## Ruling

In general, the service Corporation B provides constitutes a nontaxable transportation service. However, the charge for dinner for two at the restaurant, the use of the cellular phone and charge for champagne are subject to Wisconsin sales tax. A reasonable allocation of the gross receipts must be made between the nontaxable service and taxable sales of dinners, use of cellular phone, and champagne for purposes of imposing Wisconsin sales tax.

The dinners, telephone service, and champagne Corporation B purchases and resells as part of the package may be purchased without Wisconsin sales tax with the use of properly completed resale certificates.

To the extent that any nontaxable transportation services, as identified in this ruling, were previously included in taxable gross receipts and the tax paid, Corporation B may file amended sales and use tax returns and claim a refund of such taxes paid.

## Analysis

The first issue to be resolved is whether the taxpayer's operation is the rental of the limousine (tangible personal property) or a charge for providing a service.

Rule Tax 11.29(4), Wis. Adm. Code addresses the distinction.

“(a) A person who uses the person's own equipment to perform a job and who assumes responsibility for its satisfactory completion shall be performing a service.

(b) A person who furnishes equipment with an operator to perform a job which a lessee supervises and is responsible for the satisfactory completion of, shall be a lessor renting out such equipment. If it is customary or mandatory that the lessee accept an operator with leased equipment, the entire charge is subject to the tax. However, the operator's services shall not be taxable if billed separately and if a lessor customarily gives a lessee the option of taking the equipment without the operator.

(c) Charges for the rental of motor trucks shall be taxable. However, if drivers are provided by the truck's owner to operate the trucks and the public service commission and the department of transportation's division of motor vehicles consider the arrangement a transportation service under statute or under rules adopted by either or both of those state agencies, the charges shall not be taxable.”

Rule Tax 11.84(4)(a), Wis. Adm. Code, concerning aircraft states that transporting customers or property for hire is a nontaxable transportation service when the customer only designates the time of departure and destination while the owner retains control over the aircraft in all other respects.

Corporation B's trips clearly are a transportation service rather than the lease of tangible personal property. The driver retains control of the limousine at all times and assumes responsibility for the satisfactory completion of the trip.

Since we have determined that Corporation B is providing a nontaxable service, the second issue is whether it can file a claim for refund for sales taxes paid on the nontaxable transportation service since its inception in 1988.

Section 77.59(4), Wis. Stats. (1987-88), provides that at any time within 4 years after the due date of a taxpayer's income or franchise tax return, a person may file a claim for refund of taxes paid provided the person has not had a determination by the department by office audit or field audit.

Assuming Corporation B reports on a calendar year for income and franchise tax purposes and has not been subject to an office audit or field audit determination by the department, it has until March 15, 1993 to file a claim for taxes paid for 1988.

With respect to the charge for the use of the cellular telephone, sec. 77.52(2)(a)5, Wis. Stats., provides that the sale of telecommunication services of whatever nature, with certain exceptions, are taxable.

With regard to Corporation B's purchase of tangible personal property and taxable services that it resells to its customers, section 77.51(14)(intro.), Wis. Stats., provides that “sale at retail” for purposes of imposing sales tax does not include items for resale. Section 77.52(13) and (14), Wis. Stats., provides for the use of a resale certificate when purchasing tangible personal property or taxable services without tax for resale.

□

**W9121004, March 5, 1991**

**Type Tax: Sales/Use**

**Statutes:** Sections 77.52(1) and (2)(a) and 77.53(1), Wis. Stats. (1989-90)

**Issue:** Exemptions — incidental highway construction

This letter responds to your request for a Private Letter Ruling regarding Wisconsin sales and use tax implications of incidental highway construction work.

## Facts

Company C is in the business of incidental highway construction work, specifically, traffic control.

Company C contracts with a road building contractor to provide and maintain barricades, temporary traffic signs, and arrow boards which route traffic through a highway construction project. Maintaining barricades and signs includes periodically checking barricades and signs to see that lights are working and making sure barricades are standing. Company C owns the barricades and signs.

## Ruling Request

You ask whether the charge to the road building contractor for providing and maintaining the barricades, temporary traffic signs, and arrow boards is subject to Wisconsin sales tax. You also ask whether the purchase of barricades, temporary traffic signs, and arrow boards by Company C is subject to Wisconsin sales or use tax.

## Ruling

Company C's charge to a road building contractor for providing and maintaining barricades, temporary traffic signs, and arrow boards which route traffic through a construction project is a charge for traffic control services and is not subject to Wisconsin sales tax. The company must pay Wisconsin sales or use tax on its purchase of barricades, temporary traffic signs, and arrow boards utilized in providing the traffic control services.

## Analysis

In general, sec. 77.52(1), Wis. Stats. (1989-90), imposes a sales tax on the sale, lease or rental of tangible personal property at retail. Section 77.52(2)(a), Wis. Stats. (1989-90), imposes the tax on the furnishing of certain services.

Section Tax 11.29(4)(a), Wis. Adm. Code, provides:

"A person who uses the person's own equipment to perform a job and who assumes responsibility for its satisfactory completion shall be performing a service."

Since Company C owns the equipment it provides to the road building contractor and is responsible for maintaining it throughout the construction project, it is considered to be providing a traffic control service.

Section 77.52(2)(a), Wis. Stats. (1989-90), does not include traffic control service as a service that is subject to sales tax. Therefore, the traffic control service is not subject to sales tax.

With respect to the sale of barricades, temporary traffic signs, and arrow boards to Company C, the sale of tangible personal property in Wisconsin is subject to sales tax under sec. 77.52(1), Wis. Stats.

(1989-90), unless an exemption applies or the property is purchased for resale.

Since no exemption applies to the sale of this property to Company C and the company is not purchasing the property for resale, the sale of the property is subject to Wisconsin sales tax. If the supplier is not required to charge Wisconsin sales tax because of a lack of sufficient nexus or did not charge Wisconsin sales or use tax, Company C must pay use tax on the sales price of the property under sec. 77.53(1), Wis. Stats. (1989-90).



W9122005, March 11, 1991

**Type Tax:** Corporation Franchise or Income

**Statutes:** Sections 71.26(2)(a) and (3)(x) and 71.30(1)(a), Wis. Stats. (1989-90)

**Issue:** Accounting - 1987 and thereafter — allowable methods

This letter responds to your request for a Private Letter Ruling regarding the use of the reserve method of accounting for bad debts.

## Facts

You have stated that ABC Corporation (ABC) is a member of a parent-subsidiary controlled group of corporations as defined in Internal Revenue Code section 1563(a)(1). The average adjusted bases of all assets of the bank are less than \$500,000,000; however, the average adjusted bases of all assets of the parent-subsidiary controlled group to which ABC belongs exceed \$500,000,000. Therefore, ABC is a large bank as defined in IRC sec. 585(c)(2)(B). For federal purposes, ABC is not allowed to deduct additions to a reserve for bad debts since IRC sec. 585, which allows such deductions, does not apply to large banks.

## Ruling Requested

You have requested a ruling that since ABC is required to file a separate company return for Wisconsin purposes because IRC secs. 1501 to 1505, 1551, 1552, 1563, and 1564, relating to consolidated returns, are excluded from the Internal Revenue Code for purposes of determining net income, the determination of whether ABC is a large bank must be made on a separate company basis for Wisconsin purposes. Since the average adjusted bases of all assets of ABC are less than \$500,000,000, ABC is not a large bank. Therefore, ABC may maintain use of the reserve method for bad debts on a separate company basis for its Wisconsin return.

## Ruling

Although ABC must file a separate company return for Wisconsin purposes, it must use the same method of accounting used for



federal income tax purposes if that method is authorized under the Internal Revenue Code in effect for Wisconsin. Since IRC sec. 585 applies for Wisconsin and ABC is a large bank under IRC sec. 585(c)(2)(B), it is a large bank for Wisconsin purposes. Therefore, ABC may not maintain use of the reserve method of accounting for bad debts.

### Analysis

Beginning with the 1987 taxable year, the Wisconsin net income of a corporation is determined under the Internal Revenue Code, with certain modifications. Sec. 71.26(2)(a), Wis. Stats. (1989-90). One of the modifications excludes IRC secs. 1501 to 1505, 1551, 1552, 1563, and 1564, relating to consolidated returns, for the purpose of computing net income. Sec. 71.26(3)(x), Wis. Stats. (1989-90). However, there is no modification in the state statutes for IRC sec. 585, relating to the bad debt deduction allowable to banks. Therefore, this provision is the same for both state and federal purposes.

In addition, sec. 71.30(1)(a), Wis. Stats. (1989-90), requires a corporation to use the same method of accounting used for federal income tax purposes if that method of accounting is authorized under the Internal Revenue Code in effect for Wisconsin.

Internal Revenue Code sec. 585 allows certain banks to use the reserve method of deducting bad debts. However, IRC sec. 585(c)(1) provides that, in the case of a large bank, the section does not apply and no deductions will be allowed for any additions to a reserve for bad debts. Under IRC sec. 585(c)(2), a bank is a large bank if, for the taxable year or for any preceding taxable year beginning after December 31, 1986,

- (A) the average adjusted bases of all assets of that bank exceeded \$500,000,000, or
- (B) the bank was a member of a parent-subsidiary controlled group and the average adjusted bases of all assets of that group exceeded \$500,000,000.

Internal Revenue Code sec. 585(c)(5)(A) defines a parent-subsidiary controlled group as any controlled group of corporations described in IRC sec. 1563(a)(1). That Code section describes a parent-subsidiary controlled group as one or more chains of corporations connected through stock ownership with a common parent corporation if —

- (A) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of each of the corporations, except the common parent corporation, is owned by one or more of the other corporations, and
- (B) the common parent corporation owns stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of at least one of the other corporations, excluding, in computing such voting power or value, stock owned directly by such other corporations.

Although the definition of a parent-subsidiary controlled group under sec. 1563 affects the determination of whether a bank is a large bank, that Code section does not deny use of the reserve method for deducting bad debts to large banks. It is by virtue of IRC sec. 585 that ABC is a large bank and is disqualified from using the reserve method for bad debts. There is no provision in sec. 585 that limits the disqualification of large banks to those large banks which file consolidated returns under IRC secs. 1501 to 1505, 1551, 1552, 1563, and 1464.

Since ABC may not use the reserve method of deducting bad debts for federal purposes and IRC sec. 585 is not modified for Wisconsin purposes, ABC may not use the reserve method for bad debts for Wisconsin purposes.

□