



Wisconsin TAX BULLETIN



Towing

See article on page 1,
tax release on page 18.

New Tax Laws to Be Addressed in Special Issue

The Governor's Budget Bill, 1993 Senate Bill 44, includes several provisions affecting Wisconsin income, sales, and excise taxes. Additional bills which affect Wisconsin taxes have also been introduced.

The Wisconsin Legislature is expected to complete its current legislative session by June 30, 1993. If any bills affecting Wisconsin income, sales, or excise taxes become law, a special issue of the *Wisconsin Tax Bulletin* explaining the new laws will be published later this summer. □



Tax Treatment of Towing Changed

Effective May 1, 1993, sec. Tax 11.49(1)(c), Wis. Adm. Code, is amended to provide that all towing of tangible personal property is subject to Wisconsin sales or use tax, unless an exemption applies. Previously, towing tangible personal property was

subject to Wisconsin sales or use tax only if it was related to the repair, service, or maintenance of the property being towed.

For more information about this change, refer to the tax release on towing, beginning on page 18 of this Bulletin. □

Tax Auditors Discover Over \$17 Million in Unpaid Use Tax

As part of its auditing efforts to obtain compliance with Wisconsin's use tax laws, Department of Revenue auditors assessed over \$17 million of use tax, penalties, and interest in the fiscal year ending June 30, 1992.

Auditors found that many businesses, while properly accounting for tax on sales, fail to have a system to keep track of purchases subject to use tax. Following are examples of purchases made without a sales or use tax being paid . . . until the businesses were audited:

1. Purchases from unregistered, out-of-state sellers.
2. Purchases for which exemption certificates were issued to the seller but the item purchased was ultimately used in a taxable manner.

Purchasers should carefully review their accounting methods to ensure that use tax is properly reported. □

Telephone Company's Billing and Collection Services

Effective October 1, 1991, the gross receipts received by a local telephone company for providing billing and collection services to long-distance telecommunications service providers are not subject to Wisconsin sales or use tax. See the tax release on this subject, beginning on page 17 of this Bulletin. □

Don't Forget Temporary Recycling Surcharge

Who Is Subject to the Surcharge?

The following persons or entities are subject to the temporary recycling surcharge:

- Individuals who must file a Wisconsin income tax return, Form 1 or 1NPR, and who have, for federal income tax purposes,
 - a profit or loss from a trade or business,
 - income as a statutory employee, or
 - net farm profit.
- Estates and trusts that must file a Wisconsin fiduciary income tax return, Form 2, and that have, for federal income tax purposes,
 - a profit or loss from a trade or business,

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- statutory employee income, or
- net farm profit.
- Partnerships that must file a Wisconsin partnership return, Form 3, and that have a profit or loss from a trade or business or net farm

profit for federal income tax purposes.

- Corporations that must file a Wisconsin franchise or income tax return, Form 4 or 5.
- Tax-option (S) corporations that must file a Wisconsin franchise or income tax return, Form 5S.
- Insurance companies that must file a Wisconsin franchise tax return, Form 4I.
- Exempt corporations that are subject to the tax on unrelated business taxable income and must file Wisconsin Form 4T.
- Exempt trusts that are subject to the tax on unrelated business taxable income and must file Wisconsin Form 4T.

Who Is Not Subject to the Surcharge?

A partnership, individual, estate, trust, or exempt trust is not subject to the temporary recycling surcharge if:

- It is not engaged in farming and has less than \$1,000 of gross receipts from all trade or business activities or as a statutory employee for federal income tax purposes.

Beginning in 1992, the surcharge does not apply to income received by duly ordained, commissioned, or licensed ministers of a church in the exercise of their ministry, by members of religious orders in the exercise of duties required by the order, and by Christian Science practitioners in the exercise of their profession.

- It is engaged only in farming and has less than \$1,000 of net farm profit for federal income tax purposes.

- It is engaged in both farming and other trade or business activities and has less than \$1,000 of gross receipts from all nonfarm trade or business activities for federal income tax purposes *and* less than \$1,000 of net farm profit for federal income tax purposes.

Caution: These exceptions do not apply to corporations, tax-option (S) corporations, insurance companies, and exempt corporations.

Additional Information

For further information about the temporary recycling surcharge, including definitions of the terms "trade or business," "statutory employee," "gross receipts," and "net farm profit," refer to Wisconsin Publication 400, *Wisconsin's Temporary Recycling Surcharge*, which may be obtained from any Department of

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Revenue office. Also see the instructions for completing the various tax returns and tax releases in *Wisconsin Tax Bulletin 76* (April 1992), pages 15 to 19, and in this bulletin, pages 20 to 29. □

Information or Inquiries?

Madison - Main Office Area Code (608)

Beverage, Cigarette, Tobacco Products . . .	266-6701
Corporation Franchise and Income	266-1143
Estimated Taxes	266-9940
Fiduciary, Inheritance, Gift, Estate	266-2772
Homestead Credit	266-8641
Individual Income	266-2486
Motor Fuel	266-3223
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

Recycling Surcharge Rates Unchanged

The temporary recycling surcharge rates remain unchanged for taxable years ending after April 1, 1993, and before April 1, 1994.

Section 77.945, Wis. Stats., requires the Department of Revenue annually, in December, to establish annual recycling surcharge rates for taxable

years that end after April 1, 1992, and before April 1, 1999, that are necessary to generate sufficient revenue to fund the appropriations from the recycling fund for the following fiscal year. The annual surcharge rates must be approved by the Legislature's Joint Committee on Finance.

As a result of this process, the following surcharge rates will continue to apply for taxable years that end before April 1, 1994:

- Corporations (except tax-option (S) corporations), insurance companies, and exempt organizations taxable as corporations: The greater of \$25 or 5.5% of gross tax liability, but not more than \$9,800.
- Tax-option (S) corporations: The greater of \$25 or 0.4345% of Wisconsin net income, but not more than \$9,800.
- Partnerships, except partnerships engaged only in farming: The greater of \$25 or 0.4345% of net business income as allocated or apportioned to Wisconsin, but not more than \$9,800.
- Individuals, estates, trusts, and exempt trusts, except those entities engaged only in farming: The greater of \$25 or 0.4345% of net business income as allocated or apportioned to Wisconsin, but not more than \$9,800.
- Partnerships, individuals, estates, trusts, and exempt trusts engaged in farming: \$25, provided the entity has a net farm profit of \$1,000 or more.

Note: A provision included in the Governor's 1993-1995 Budget Bill would alter the effective date of temporary recycling surcharge rate changes. If this provision is enacted, new rates will apply for taxable years

beginning on the January 1 after the department notifies the Joint Committee on Finance. For example, if a rate change is proposed in December 1993 and approved by the Joint Committee on Finance, the new rates will first apply to taxable years beginning on January 1, 1994.

If the recycling surcharge rates change, the new rates will be published in a future issue of the *Wisconsin Tax Bulletin*. □

No Criminal Prosecution for Some Late Filers

Wisconsin residents who come forward voluntarily and file one or more late Wisconsin income tax returns before being contacted by the Department of Revenue will not be criminally prosecuted. This practice applies to individuals who 1) filed one or more late returns with the Department, 2) had only legal source income (that is, no part of the income was earned from activity which is illegal under federal or state law), 3) filed a true or correct tax return or returns, and 4) filed before being contacted by letter or telephone by the department.

This practice is similar to the Internal Revenue Service position as announced under its nationwide "non-filer program."

Delinquent interest, fees, and civil penalties on late filed returns may be assessed as provided in the law.

Nonfilers may call the department at (608) 266-1961 to obtain forms and instructions. Nonfilers may obtain assistance in completing and filing their returns by calling (608) 266-2772 or by visiting any of the Department's offices located throughout the state. Locations of Department of Revenue offices are listed in state tax booklets. □

Annual Bulletin Index Available

Once each year the *Wisconsin Tax Bulletin* includes an index of materials that have appeared in past Bulletins. The latest index available appears in *Wisconsin Tax Bulletin* 78 (July 1992) and includes information for issues 1 (October 1976) to 75 (January 1992). □

Department of Revenue Wins IRS Accuracy Award

"The professionalism and dedication of Wisconsin Department of Revenue (DOR) employees has been confirmed by an unusual source — the Internal Revenue Service (IRS)," State Revenue Secretary Mark D. Bugher has reported.

"The IRS relies heavily on electronic data supplied by banks, employers, state tax agencies, and others on Form 1099 and W-2 documents to validate individual income tax return information reported by taxpayers. In December 1992, we learned that DOR is one of only 16 organizations nationwide to receive the 'IRS Quality Supplier Award' for accurately filing over 500,000 error-free reports in 1990 and 1991.

"This high level of accuracy helps both taxpayers and government. The award highlights the outstanding quality of public service our employees have achieved in a variety of activities. Taxpayers know about programs like Quick Refund that directly improve taxpayer service. But many of our efforts to make government more effective and efficient escape public attention. I am pleased to accept this unique award on behalf of DOR employees as an affirmation of our strong commitment to quality public service," Secretary Bugher concluded. □

Wanted: Your Comments or Suggestions

Do you have comments, ideas, or suggestions for improving Wisconsin's tax forms or instructions? Do you have ideas which could be helpful in administering Wisconsin's tax programs? If so, the department is interested in hearing from you.

Send your comments, ideas, or suggestions to the Wisconsin Department of Revenue, Director of Technical Services, P.O. Box 8933, Madison, WI 53708-8933. □



Need a Speaker?

Are you planning a monthly meeting or training program? The Wisconsin Department of Revenue provides speakers to business, community, and educational organizations.

Department representatives are available to speak on a variety of topics that can be targeted toward your group's particular areas of interest, including:

- New income and corporate tax laws.
- How sales tax affects contractors, landscapers, manufacturers, non-profit organizations, or businesses in general.
- What to expect in an audit.
- Common errors discovered in audits.
- Homestead credit.
- Farmland preservation credit.

To arrange for a speaker, please write to Wisconsin Department of Revenue, Speakers Bureau, P.O. Box 8933, Madison, WI 53708-8933, or call (608) 266-1911. □

Topical and Court Case Index Available

Are you looking for a convenient way to locate reference material so you can research a particular Wisconsin tax question? The *Wisconsin Topical and Court Case Index* will help you find reference material for use in researching your Wisconsin tax questions. This index references Wisconsin statutes, administrative rules, *Wisconsin Tax Bulletin* articles, tax releases, publications, Attorney General opinions, and court decisions.

The first part of the index, the "Topical Index," gives references to alphabetized subjects for the various taxes, including individual income, corporation franchise and income, withholding, sales and use, gift, inheritance and estate, cigarette, tobacco products, beer, intoxicating liquor and wine, and motor fuel, special fuel, and general aviation 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.

If you need an easy way to research Wisconsin tax questions, consider subscribing to the *Wisconsin Topical and Court Case Index*. The annual cost is \$14, plus sales tax. The \$14 fee includes a volume published in December, and an addendum published in May.

To order your copy, complete the order blank that appears on page 39 of this Bulletin. The order blank may also be used for subscribing to the *Wisconsin Tax Bulletin* and for ordering the Wisconsin Administrative Code. □

Focus on Forms: Reporting County Tax on Form ST-12

If county sales or use tax is reported on line 13 or 22 of the Wisconsin State and County Sales and Use Tax Return (Form ST-12), Schedule CT on the back of the return must be completed.

Schedule CT must be completed so that the department can accurately determine the amount of county tax that must be distributed to each county that has adopted the county tax. Failure to complete Schedule CT when required can result in a delay in processing the return.

For more information about the county tax, refer to the December 1992 *Sales and Use Tax Report in Wisconsin Tax Bulletin 80* (January 1993), pages 45 to 48. ☐

Wisconsin State and County Sales and Use Tax Return

SALES
TAX
DUE

13 1/2 % county sales tax (from line B, Schedule CT, on reverse side)..... 13

USE
TAX
DUE

22 1/2 % county use tax (from line C, Sch. CT, on reverse side)..... 22

SCHEDULE CT

RECEIPTS AND PURCHASES SUBJECT TO COUNTY SALES & USE TAX

(See instructions for completing this schedule. Do not enter zero (0) if there is no tax due)

EFFECTIVE the first day of month and year shown following the county name

County	Column 1 Receipts Subject to County Sales Tax	Column 2 Purchases Subject to County Use Tax
Name Code		

A. TOTAL ▷ A

B. 1/2% county sales tax (Multiply line A, col. 1 by .005. Enter this amount on line 13 on the front of this return.) ▷ B

C. 1/2% county use tax (Multiply line A, col. 2 by .005. Enter this amount on line 22 on the front of this return.) ▷ C

Reporting for Craft Sales and Flea Markets

Operators of temporary sales events such as swap meets, flea markets, and craft fairs, are required to furnish to the Department of Revenue a listing providing information about vendors selling merchandise at the event.

The listing should contain the following information: the name of the event; the date or dates and location of the event; and the real name, business name, address, social security number and, if available, the seller's permit number of each vendor at the event.

The listing is due within 10 days after the close of the event.

Reporting forms and information about the reporting requirements may

be obtained at any department office, by writing to Wisconsin Department of Revenue, P.O. Box 8902, Madison, WI 53708, or by calling (608) 266-2776. ☐

Retailers Cannot 'Absorb' Sales Tax for Customers

Occasionally, retailers advertise that they will 'absorb' sales tax for their customers. *This practice violates state law.*

It is illegal for any retailer to advertise, hold out, or state to the public or to any customer, that sales tax will be assumed or absorbed by the retailer or that it will not be added to the selling price.

Retailers may, however, advertise that their price 'includes' sales tax. ☐

Extension of Time to File for Individuals

A new condition that individuals must meet in order to be allowed an extension of time to file their 1992 Wisconsin income tax return, is that they estimate their Wisconsin tax and pay the amount they expect to owe with their 1992 return, by the unextended due date (e.g., April 15, 1993, for a calendar year filer). This new payment requirement applies to all extensions for individuals, except extensions available because an individual is outside the United States and Puerto Rico on April 15, or in a combat zone.

Extensions of time provided by federal law or granted by the Internal Revenue Service (IRS) for filing a federal income tax return continue to be available to extend the time for filing a Wisconsin income tax return.

Extensions available under federal law may be used for Wisconsin purposes, even though an individual does not need an extension to file his or her federal return with IRS. The 30-day "Wisconsin only" extension available in previous years has been repealed.

For further information on extensions of time for filing a Wisconsin income tax return, see the tax release titled "Extension of Time to File Franchise and Income Tax Returns" in *Wisconsin Tax Bulletin 80* (January 1993), page 28. □

1993 Estimated Tax Requirements for Individuals, 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. Every individual, married couple filing jointly, estate, or trust (except certain estates and grantor trusts, as explained below), is required to pay 1993 Wisconsin estimated tax if they expect to owe \$200 or more on a 1993 Wisconsin income tax return. Form 1-ES, "1993 Wisconsin Estimated Tax Voucher," is filed with each estimated tax payment.

For calendar year taxpayers, the first estimated tax payment is due on April 15, 1993. Installment payments are also due on June 15, 1993, September 15, 1993, and January 18, 1994. For fiscal year taxpayers, installment payments are due on the 15th day of the 4th, 6th, and 9th months of the fiscal year and the 1st month of the following fiscal year.

Estates and 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 March 25, 1993. 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 March 25, 1995.

A trust which is subject to tax on unrelated business income is generally required to pay 1993 Wisconsin estimated tax if it expects to owe \$500 or more on a 1993 Wisconsin franchise or income tax return (Form 4T). A 1993 Form 4-ES, "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 individual, married couple filing jointly, estate, or trust does not make the estimated tax payments when required or underpays any installment, interest may be assessed. □

Filing Wisconsin Fiduciary and Estate Tax Returns

Wisconsin Fiduciary Returns

Who Must File

Every personal representative or special administrator of the estate of a Wisconsin decedent and every trustee of a Wisconsin trust must file a Wisconsin fiduciary income tax return (Form 2) if the gross income of the estate or trust exceeds \$600. Nonresident estates and trusts must file Wisconsin fiduciary returns if they have gross income in excess of \$600 from Wisconsin sources.

Trusts must file on a calendar-year basis, and the due date is the following April 15. (Exception: a limited number of charitable trusts may still

file on a fiscal basis.) Estates can choose any fiscal year, but the first return may not cover more than a 12-month period and the taxable year must end the last day of a month. The due date for fiduciary returns for estates is 3½ months after the close of the fiscal year.

Closing Certificates

Every executor, administrator, personal representative, or trustee applying to a court in Wisconsin having jurisdiction for discharge must obtain a Closing Certificate for Fiduciaries from the department. Before the certificate will be issued, all required income, gift, sales, use, and withholding tax returns and reports, with the exception of the final income tax return of the estate or trust, must be filed.

With the next-to-final fiduciary return, estates must submit a copy of the probate inventory and a copy of the decedent's will. Trustees must submit a statement as to why the trust is closing, a schedule of assets held by the trust, and a copy of the trust agreement (or will creating such trust) if not submitted with a prior return.

If an estate or trust has less than \$600 of income and needs a Closing Certificate for Fiduciaries, the top one-third of the Form 2 should be completed. At line 1, "No 1041 Required" should be inserted. Any required documents must be attached to the Form 2 filed.

The department shall determine that all income, withholding, sales, use, gift, and delinquent taxes are paid. A Closing Certificate for Fiduciaries will then be issued. This does not relieve the executor, administrator, personal representative, or trustee from filing the final fiduciary income tax return. If a probate final account is filed with the court, a copy must be attached to the final return.

For the fiscal year ending June 30, 1992, the department issued nearly 17,000 Closing Certificates for Fiduciaries.

Wisconsin Estate Tax Returns

Filing Requirement

An estate is required to file a Wisconsin estate tax return (Form W706) if it is required to file a federal estate tax return. An estate is required to file a federal estate tax return (Form 706) if the gross estate at date of death plus gifts in excess of \$10,000 made to each donee per calendar year since December 31, 1976, exceeds \$600,000.

The Wisconsin estate tax is equal to the credit for state death taxes allowed on the federal estate tax return (line 15 of federal Form 706). This credit is computed under section 2011 of the Internal Revenue Code. Estates owning property within and without Wisconsin owe a percentage of the credit to Wisconsin based on gross Wisconsin property divided by gross total property.

Due Date

The personal representative, special administrator, trustee, or distributee must file the Wisconsin estate tax return by the due date, which is 9 months after the date of death or the extended due date allowed by the Internal Revenue Service.

If the return is filed after the due date, there is a penalty equal to 5% of the tax with a minimum of \$25 and a maximum of \$500.

Payment of Tax

The tax is due 9 months after the decedent's date of death, even if an extension has been obtained to file the return.

If the tax is not paid within 9 months of the decedent's death, interest is imposed at 1% per month from the date of death.

Examples:

1. Decedent Able died February 15, 1992. An extension of time to file the federal estate tax return was obtained from the Internal Revenue Service. The Wisconsin estate tax return and payment of the tax were submitted on November 30, 1992, which was within the extension period. Tax of \$1,200.00 was due. The total amount due is \$1,314.00, computed as follows:

Tax	\$1,200.00
Interest (9½ months @ 1% per month)	<u>114.00</u>
Total amount due	<u>\$1,314.00</u>

2. Decedent Body died February 15, 1992 and did not obtain an extension to file from the Internal Revenue Service. The Wisconsin estate tax return was filed November 30, 1992, and showed no tax due. This estate would owe the minimum penalty of \$25.00.

Certificate Determining Estate Tax

Upon receipt of the Wisconsin estate tax return and review for correctness, the department will issue a Certificate Determining Estate Tax. If the Internal Revenue Service increases or decreases the federal estate tax, the person entitled to the refund or liable for the additional tax is required to notify the department within 30 days. □

Programs Help Farmers and Protect Farmland

Nearly \$45 million in direct benefits were distributed to Wisconsin farmers in 1992 through two state programs,

the farmland preservation credit program and the farmland tax relief credit program. About 25,000 Wisconsin farmers claimed farmland preservation credits amounting to \$29.7 million in the fiscal year ending June 30, 1992, and more than 63,000 individual farmers received farmland tax relief credits totalling \$15.2 million for 1991.

Farmland Preservation Credit

In addition to providing benefits averaging \$1,188 per claimant, the farmland preservation credit program is helping to protect 8.1 million acres of farmland through local land use planning and soil conservation practices.

To qualify for a benefit under this program, farmland must be zoned for exclusive agricultural use or be subject to a farmland preservation agreement between the farmer and the state. About 78% of the claims for the fiscal year ending June 30, 1992, were for land under zoning and 22% were for land covered by agreements.

Farmland Tax Relief Credit

Farmland tax relief credits averaging \$236 were paid to individual farmers statewide for 1991 income tax returns. These credits equal 10% of the first \$10,000 of property taxes on qualifying farmland, exclusive of improvements. This program, which is in addition to the farmland preservation credit, provides direct benefits to virtually all farmers in the state.

The farmland tax relief credit is available to both individuals and corporations. In addition to the farmland tax relief credits claimed by farmers on their individual income tax returns, corporate farms claimed about \$452,000 in credits statewide for 1991. □

Error in 1991-92 Statutes

The amendment to sec. 71.83(3), Wis. Stats., regarding late filing fees, by 1991 Wisconsin Act 190, was omitted from the official certified volumes of the 1991-92 Wisconsin Statutes. Wisconsin law provides that any error in the publication of the statutes does not preclude the legislation from being law. Therefore, sec. 71.83(3) as affected by Act 190 is the law of Wisconsin. The correct version of sec. 71.83(3), Wis. Stats. (1991-92), is reproduced below.

Section 71.83(3) LATE FILING FEES. If any person required under this chapter to file an income or franchise tax return fails to file a return within the time prescribed by law, or as extended under s. 71.03(7), 71.24(7) or 71.44(3), unless the return is filed under such an extension but the person fails to file a copy of the extension that is granted by or requested of the internal revenue service, the department shall add to the tax of the person \$30 in the case of corporations and in the case of persons other than corporations \$2 when the total normal income tax of the person is less than \$10, \$3 when the tax is \$10 or more but less than \$20, \$5 when the tax is \$20 or more, except that \$30 shall be added to the tax if the return is 60 or more days late. If no tax is assessed against any such person the amount of this fee shall be collected as income or franchise taxes are collected. □

Administrative Rules in Process

Listed below are proposed new administrative rules and amendments to existing rules that are currently in the rule adoption process. The rules are shown at their stage in the process as of April 1, 1993, or at the stage in which action occurred during the period from January 2, 1993, to April 1, 1993.

Each affected rule lists the rule number and name, and whether it is amended (A), repealed (R), repealed and recreated (R&R), or a new rule (NR).

Rules at or Reviewed by Legislative Council Rules Clearinghouse

- 11.27 Warranties-R&R
- 11.66 Telecommunication and CATV services-R&R
- 11.82 Mailing lists and mailing services-A

Rules Sent to Revisor of Statutes for Publication of Notice or Hearing Date

- 11.04 Constructing buildings for exempt entities-A
- 11.15 Containers and other packaging and shipping materials-A
- 11.67 Service enterprises-A
- 11.675 Janitorial services-NR
- 11.68 Construction contractors-A

Rules Sent to Legislative Committees

- 2.31 Taxation of personal service income of nonresident professional athletes-R
- 11.38 Fabricating and processing-R&R
- 14.03 Household income and income-A

Rules Adopted But Not Yet Effective

- 2.02 Reciprocity-A
- 2.955 Credit for taxes paid to other states-A
- 11.03 Elementary and secondary schools and related organizations-A
- 11.05 Governmental units-A
- 11.08 Medical appliances, prosthetic devices and aids-A
- 11.12 Farming, agriculture, horticulture and floriculture-A
- 11.17 Hospitals, clinics and medical professions-A
- 11.18 Dentists and their suppliers-A
- 11.33 Occasional sales-A
- 11.45 Sales by pharmacies and drug stores-A
- 11.49 Service stations and fuel oil dealers-A
- 11.57 Public utilities-A
- 11.70 Advertising agencies-R&R
- 11.71 Computer industry-A
- 11.83 Motor vehicles-A
- 11.84 Aircraft-A
- 11.85 Boats, vessels and barges-A
- 11.88 Mobile homes-A
- 11.95 Retailer's discount-A □



Report on Litigation

Summarized below are recent significant Wisconsin Tax Appeals Commission (WTAC) and Wisconsin Court decisions. The last paragraph of each decision indicates whether the case has been appealed to a higher Court.

The following decisions are included:

Individual Income Taxes

Independent contractor — defined
Robert A. Vitt and Lisa A. Vitt (p. 9)

Corporation Franchise and Income Taxes

Accounting — 1986 and prior — change in accounting period
Interest income — 1986 and prior — U.S. obligations
M.B. Investment Corp. (p. 10)

Allocation of income — business or nonbusiness income
Citizens Publishing Company of Wisconsin, Inc. (p. 10)

Deductions — 1986 and prior — contingent liabilities
Barrett Landfill, Inc. (p. 11)

Leases — 1986 and prior — safe harbor rules
International Paper Company (p. 12)

Sales and Use Taxes

Occasional sales — business assets
Mail N'More, Inc. (p. 12)

Rebates

Refunds — exhausting administrative remedies
John Grall, et al. (p. 12)

INDIVIDUAL INCOME TAXES

Independent contractor — defined. *Robert A. Vitt and Lisa A. Vitt vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, December 31, 1992). The issue in this case is whether the taxpayer was an independent contractor or an employee. In 1989 the taxpayer was a "training agent" for an insurance company whose duties were to sell insurance and help policy holders and the company with reporting and handling claims.

The case arises in the context of whether the taxpayer should have been allowed to deduct in full the expenses he incurred in performing the contract. Originally reporting the expenses as employee business expenses, the taxpayer later filed a claim for refund, putting the expenses on Schedule C, and reporting them as 100% deductible business expenses.

With the refund claim, the taxpayer recharacterized himself as an independent contractor rather than an employee. The department denied the refund claim and argues that the taxpayer was an employee.

The Commission weighed the following factors:

1. Minimal instruction was given to the taxpayer. The taxpayer was left almost completely alone as to the when, where, and how of his work.
2. The taxpayer had prior experience and needed virtually no training.

3. The degree to which the success or continuation of the company depended upon the taxpayer's performance of services.
4. The taxpayer had authority to delegate duties.
5. The taxpayer had authority to hire, fire, and supervise his own employees.
6. The taxpayer had a four-year affiliation with the company.
7. The taxpayer had no set hours of work.
8. The taxpayer was contractually prohibited from offering his services to others.
9. The taxpayer's headquarters was his own office.
10. The taxpayer was not required to perform services in a prescribed sequence.
11. The taxpayer was not required to submit regular reports, other than the insurance applications sent to get the insurance in force.
12. The taxpayer was paid a base compensation of \$1,200 per month plus commissions and other incidental compensation of \$3,839.
13. The taxpayer is contractually responsible for all his own expenses.

14. Except for some company literature, all "tools," materials and equipment were supplied by the taxpayer.
15. The taxpayer had a very significant investment in facilities — the office at a rental of \$12,000 per year.
16. The taxpayer was at risk to realize a profit or suffer a loss as a result of his services, although the risk was somewhat mitigated by the \$1,200 guaranteed payment.
17. The taxpayer's services were not available to the general public.
18. The company could not discharge the taxpayer at will, but only for the taxpayer's failure to meet contract specifications.
19. The taxpayer could quit instantaneously on notice.

The Commission concluded that the taxpayer was an independent contractor, allowing the refund claim.

The department has 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. The decision is provided for informational purposes only. □

CORPORATION FRANCHISE AND INCOME TAXES

— **Accounting — 1986 and prior — change in accounting period; Interest income — 1986 and prior — U.S. obligations.** *M. B. Investment Corp. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission,

November 5, 1992). The issue in this case is whether the taxpayer's final taxable year was a 1986 tax year, subjecting the taxpayer to the special franchise tax on interest income from obligations of the U.S. government.

As a result of its complete liquidation and dissolution on May 31, 1986, the taxpayer timely filed a Wisconsin franchise tax return for the period beginning September 1, 1985, and ending May 31, 1986. The taxpayer did not request the permission of the department to change the end of its Wisconsin tax year from August 31 to May 31.

It is the taxpayer's position that, because of its liquidation and dissolution, it was no longer in existence and was statutorily mandated to file a franchise tax return for the period September 1, 1985, to May 31, 1986, and, accordingly, it was not required to request or obtain the department's permission to change its taxable year.

It is the department's position that the taxpayer was required to obtain such permission.

During the period under review, although the federal taxable year was determined according to the *first* month of a fiscal year, Wisconsin law provided for a corporate taxable year determined according to its fiscal year-end, with those fiscal years ending during the period between July of one calendar year and June of the following year being considered as filings corresponding to the earlier calendar year.

For a dissolving corporation ending business prior to the end of its fiscal year and filing a final short-period return, the department's administrative practice was to treat the return as being for the taxable year ending at the (later) normal fiscal year-end

without regard to the dissolution unless permission to change its tax year had been requested and granted. This was the treatment accorded the taxpayer's final return.

The Commission concluded that the taxpayer's final taxable year was a 1986 tax year. The taxpayer was subject to the special franchise tax on interest income from obligations of the U.S. government, pursuant to sec. 71.01(2), Wis. Stats. (1985-86).

The controlling statutory language, sec. 71.10(3m)(a) and (b), Wis. Stats. (1985-86), provides that corporations may not change their basis of reporting without first obtaining the department's approval and that in no case shall a separate income tax return be made for a period of more than 12 months.

The taxpayer has appealed this decision to the Circuit Court. □

— **Allocation of income — business or nonbusiness income.** *Wisconsin Department of Revenue vs. Citizens Publishing Company of Wisconsin, Inc.* (Circuit Court for Dodge County, December 30, 1992). The department appeals the Wisconsin Tax Appeals Commission decision dated May 6, 1992, which modified a franchise tax determination by the department against the taxpayer.

The issues in this case are:

- A. Whether, in 1982-1984, the taxpayer's income from the rental of equipment to a lessee in Minnesota was nonbusiness or business income within the meaning of sec. 71.07(1m), Wis. Stats. (1981-82).
- B. Whether, in 1981, the taxpayer was required to include a portion of its total data processing, ac-

counting, and administration expenses in calculating expenses related to its income from the rental of equipment to a lessee in Minnesota under sec. 71.07(2), Wis. Stats. (1978-80), and, if so, what portion should be included.

As to the first issue presented, the department claims that the income received by the taxpayer from the rental of equipment in Minnesota was received in the regular course of the taxpayer's trade or business and is, therefore, business income. The Commission reached the opposite conclusion in its decision.

The Commission held that, under sec. 71.07(1m), Wis. Stats. (1981-82), and sec. 71.07(2), Wis. Stats. (1978-80), the rental income from the taxpayer's rental property "shall be allocable and 'follow the situs of the property from which derived' if that rental income constitutes 'nonbusiness' income." The Commission then found sec. Tax 2.39(6), Wis. Adm. Code, to be "determinative" in establishing that the taxpayer's rental income was nonbusiness income.

As to the second issue presented, the department claims that approximately 4% of the taxpayer's total data processing, accounting, and administrative expenses for 1981 should be allocated to the Minnesota rental activity income for 1981. The Commission, however, determined that only those expenses which related to the taxpayer's Minnesota rental activity should be included.

The Commission looked to sec. 71.07(2), Wis. Stats. (1978-80), which provided, in relevant part, "there shall first be deducted from the total net income of the taxpayer such part thereof (less related expenses, if any) as follows the situs of the property . . . of the recipient."

The Circuit Court affirmed the Commission's decision, concluding that:

- A. Since the taxpayer's regular "trade or business" was commercial printing, the Commission reasonably concluded that the income from rental activity in Minnesota was nonbusiness income allocable to the State of Minnesota.
- B. Since the situs of the rental property was the State of Minnesota, the Commission reasonably concluded that only the **related** expenses should be included in computing the income from the taxpayer's rental activity (emphasis added). The Commission accordingly rejected the department's allocation of 4% of the taxpayer's total expenses as an "arbitrary allocation" by the department.

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

— Deductions — 1986 and prior — contingent

liabilities. *Barrett Landfill, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, October 27, 1992). The issue in this case is whether the taxpayer, a landfill operator and accrual basis taxpayer, was entitled to deduct estimated future landfill closure costs it will have to pay, pursuant to state regulations, when the landfill reaches its full capacity and has to be closed.

In the years involved, 1985-86, federal law permitted landfill operators to deduct estimated landfill closure costs. However, Wisconsin law contained a provision that disallowed deductions for "contingent losses or liabilities." The department disallowed the taxpayer's estimated closure cost deductions in those years, as

a "contingent" liability; but because Wisconsin "federalized" its corporate income tax as of 1987 and allowed transitional adjustments to reconcile federal and state accounting procedures, the department advised the taxpayer that it could file amended returns taking the claimed deductions over five years beginning in 1987.

The Commission concluded that the taxpayer was not entitled to deduct the estimated future landfill closure costs.

The case turns on whether the estimated landfill closure liability is "contingent" — that is, whether the liability is definite or not. In Wisconsin, for accrual basis taxpayers, a liability is definite and deductible if "the events which fix the amount of the taxpayer's liability . . . have come about or occurred before the end of the tax year in which the deduction is made."

The test contains two elements for deductibility. First, the liability must have been incurred in the sense that the events giving rise to the *fact* of liability must all have occurred in the deduction year — the "liability" cannot be merely potential. Second, the fact of some liability is not enough — the *amount* of the obligation must also be known in the deduction year.

Although the taxpayer met the first element of the deductibility test since there is a virtual certainty that the taxpayer will have to spend some money to close the landfill, the second element — a known amount of liability in the year the deduction was claimed — was not established. No one can say just what the closure will ultimately cost.

The taxpayer has not appealed this decision. □

Leases — 1986 and prior — safe harbor rules.

Wisconsin Department of Revenue vs. International Paper Company (Circuit Court for Dane County, December 28, 1992).

The department appeals the Wisconsin Tax Appeals Commission decision of May 8, 1992. For a summary of that decision, see *Wisconsin Tax Bulletin* 79 (October 1992), page 14.

The issue in this case is whether the cash payments the taxpayer received from the transfer of federal tax benefits under "safe harbor leases" were includable in its gross income under sec. 71.03(1)(k), Wis. Stats. (1981-82).

The department's position was that the proceeds from the sale of the safe harbor leases are revenue and should be subject to tax under sec. 71.03(1)(k), Wis. Stats. (1981-82). Significant to the department's position is that for the years at issue, Wisconsin had not "federalized" its tax code and exemptions created under the federal law were not controlling in Wisconsin for state tax law issues. Sec. 71.03(1)(k), Wis. Stats. (1981-82) provides that gross income included all gains, profits, or income of any kind derived from any source whatever, except such as is exempt.

Ordinarily, without the enabling legislation, lease devices such as sanctioned by the federal legislation would be considered shams for tax treatment purposes. However, the federal law provided this special exception. Unfortunately, the federal legislation did not determine how state law should view safe harbor leases.

The Court agreed with the Commission that the issue is not one of "tax exemption," but is one of a recognized accounting practice, the treatment of the sale of an indivisible

portion of a capital asset. The purchase of machinery and equipment by the taxpayer was the acquisition of capital assets which are not expensed, but depreciated. By the sale of the tax benefit provided by the federal law, the taxpayer is reducing the tax basis of the acquired capital assets. In two reported cases, both California and Oregon agree with this reasoning, as did the Commission. The reasoning is that the tax benefit is predicated upon it being an inseparable part of the equipment.

The Circuit Court concluded that the payments received under the safe harbor leases constitute a partial recovery of the taxpayer's basis in leased assets.

The department has not appealed this decision. □

SALES AND USE TAXES

Occasional sales — business assets. *Mail N' More, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, December 4, 1992). This is a decision on the department's petition for rehearing of the Commission's September 28, 1992, decision.

The issue in this case is whether the taxpayer is entitled to an exemption from sales tax on its sale of business assets. Wisconsin law allows an occasional sale exemption for sales of business assets used to conduct a trade or business at a location if the sale occurs after the seller has ceased operating the business at that location, and the seller surrenders its seller's permit to the department within 10 days after the last sale of personal property at that location.

On December 31, 1990, the taxpayer, a retailer, ceased its business operations, sold the business assets it used at that location, and filed a sales tax

return in which it reported the sale of the assets. The taxpayer did not physically surrender its seller's permit to the state until several months later.

On September 28, 1992, the Commission concluded that since the ultimate objective of the permit surrender statute is to give the state timely notice of the sale of a business, and the taxpayer did notify the state in writing of the sale in time, it substantially complied with the condition precedent to the occasional sale exemption. The requirement of surrender of the physical permit was not necessary under the circumstances.

Upon review of the decision and the department's petition for rehearing, the Commission reversed its September 28, 1992, decision. The Commission concluded that since the language of the statute is clear and unambiguous, and since the taxpayer failed to comply with it by timely delivering its seller's permit to the department, the taxpayer is not entitled to an exemption from sales tax on its sale of business assets.

The taxpayer has appealed this decision to the Circuit Court.

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. □

Rebates; Refunds — exhausting administrative remedies. *John Grall, et al., vs. Mark Bugher, Secretary of the Wisconsin Department of Revenue* (Circuit Court for Dane County, September 22, 1992).

The taxpayers are recent purchasers of new automobiles. They have challenged the department's refusal to exclude manufacturer's rebates from

the sales price for sales tax computation. The department has moved to dismiss on several grounds.

The issues are:

- A. Whether the taxpayers are required to exhaust their administrative remedies before pursuing this action in Circuit Court.
- B. Whether the complaint is barred under the doctrines of sovereign immunity and qualified immunity.
- C. Whether the taxpayers' claim is barred because of their failure to comply with the notice of claim requirements under sec. 893.82, Wis. Stats.

Discounts on automobile purchase prices are routinely used by auto manufacturers and retailers to encourage customers to purchase cars. Different methods of price reductions include: manufacturers selling models to dealers at lower prices so the dealer can pass the savings on to the customer (manufacturer's reduction); manufacturers returning some portion of the purchase price paid by the dealer when the automobile is sold (a holdback); dealer incentives (dealers are remitted a certain amount of money for each car sold); and a manufacturer's rebate (the manufacturer reduces the sales price to the purchaser and remits the rebate to the dealer).

Each of the incentive programs has an identical impact on the automobile purchaser at the point of sale. If a person purchases a \$15,000 car advertised as reduced to \$14,000, he or she will pay only a net of \$14,000 regardless of the particular reduction program in place.

The department, however, taxes these various incentive programs different-

ly. Price reductions via manufacturers' reductions, holdbacks, and dealer incentives result in a sales tax on the reduced price of the automobile. However, a purchaser who pays a reduced price for a car because of a manufacturer's rebate is taxed on the full original price, although the purchaser's cash outlay is the same as the other automobiles purchased under one of the other price reduction schemes.

The taxpayers claim this taxing scheme violates sec. 77.51(15)(b)1, Wis. Stats., the Fourteenth Amendment of the United States Constitution, 42 U.S.C. sec. 1983, and Article VIII of the Wisconsin Constitution. The taxpayers are seeking a declaration of these violations and a permanent injunction against the continued enforcement of the taxation scheme. In addition, the taxpayers ask that the Secretary of the Department of Revenue be temporarily enjoined from disbursing taxes collected on rebates while this case is pending, requesting that the funds so collected be set aside and sequestered.

The department asserts that this Court has no jurisdiction to hear this action because the taxpayers have not exhausted their administrative remedies. In addition, the department argues the complaint fails to state a claim upon which relief can be granted because the complaint is barred under the doctrines of sovereign immunity and qualified immunity. Finally, the department claims that the state cause of action filed by the taxpayers is barred because the taxpayers failed to comply with the notice of claim requirement set out in sec. 893.82, Wis. Stats.

The Court concluded that:

- A. The taxpayers must exhaust their administrative remedies if they wish to pursue declaratory relief.

For state tax matters, a party challenging a state taxing scheme may be required to exhaust available administrative remedies before instituting a sec. 1983 challenge. The policy reasons behind requiring exhaustion are: 1) subsequent judicial review will be facilitated by allowing an agency to exercise its particular expertise in a given area; 2) exhaustion allows an agency to develop a factual record which can be reviewed in subsequent proceedings; 3) it gives the agency an opportunity to correct errors; and 4) judicial time is conserved because the agency may be able to grant the relief required.

- B. The department has properly raised the defense of sovereign immunity, depriving the Court of jurisdiction over the taxpayers' monetary claims. The Wisconsin Legislature has made a clear determination of who should be eligible for refunds under the state tax laws, and the taxpayers do not fit into that category.
- C. The taxpayers did not serve notice of their claim on the Attorney General as required by sec. 893.82, Wis. Stats.

Because the taxpayers' monetary claim is otherwise barred by the doctrine of sovereign immunity, and the taxpayers have failed to exhaust their administrative remedies for declaratory relief, the department's motion to dismiss is granted and the case is dismissed.

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



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. Taxable Status of Interest Income Received From Certain Securities (p. 14)

Sales and Use Taxes

2. Separate Charges for Packaging Materials Used to Ship Tangible Personal Property to Customers (p. 15)
3. Shipping Materials — No Exemption for In-Transit Bracing Materials (p. 16)
4. Telephone Company's Billing and Collection Services (p. 17)
5. Towing Motor Vehicles (p. 18)

Temporary Recycling Surcharge

6. Application of the Temporary Recycling Surcharge to Partnerships (p. 20)
7. Temporary Recycling Surcharge — Individual Retirement Arrangements (p. 28)

INDIVIDUAL INCOME TAXES

1 Taxable Status of Interest Income Received From Certain Securities

Statutes: Section 71.05(6)(a)1 and (b)1, Wis. Stats. (1991-92)

Wis. Adm. Code: Section Tax 3.095, June 1991 Register

Background: Section 71.05(6)(a)1, Wis. Stats. (1991-92), provides that interest income which is taxable for Wisconsin purposes, but which is not included in federal adjusted gross income, must be added to federal adjusted gross income in computing Wisconsin taxable income. Therefore, if interest from the securities listed below as taxable was not included in federal adjusted gross income, such interest must be added to federal adjusted gross income in computing Wisconsin taxable income.

Section 71.05(6)(b)1, Wis. Stats. (1991-92), provides that the amount of interest or dividend income which is by federal law exempt from taxation by Wisconsin may be subtracted from federal adjusted gross income in computing Wisconsin taxable income. Therefore, if interest from the securities listed below as nontaxable was included in federal adjusted gross income, such interest may be subtracted from federal adjusted gross income in computing Wisconsin taxable income.

For Wisconsin individual income tax purposes, the taxable status of interest

from the following securities is as indicated below:

	Non-taxable	Taxable
Environmental Financing Authority obligations (33 U.S.C. §1281)		X
General Services Administration Public Building Trust Participation Certificates (31 U.S.C. §3124)	X	
HUD/New Communities Program obligations (42 U.S.C. §4514)		X
Jonathan Development Corporation obligations which are guaranteed under the New Communities Act of 1968 (42 U.S.C. §4514)		X
Panama Canal Zone bonds (31 U.S.C. §§743-745)	X	
Robert F. Kennedy Stadium bonds (D.C. Code §2-1720 et seq.)		X

Note: For additional listings of the taxable status of interest or dividends from government securities, refer to sec. Tax 3.095, Wisconsin Administrative Code, June 1991 Register, and the tax release titled "Interest Received From Resolution Funding Corporation Bonds" in *Wisconsin Tax Bulletin* 71 (April 1991), page 14. □

SALES AND USE TAXES

Note: The following tax releases interpret the Wisconsin sales and use tax law as it applies to the 5% state sales and use tax. The ½% county sales and use tax may also apply. For information on sales or purchases that are subject to the county sales and use tax, refer to the December 1992 issue of the *Sales and Use Tax Report*. A copy can be found in *Wisconsin Tax Bulletin* 80 (January 1993), page 45.

2 Separate Charges for Packaging Materials Used to Ship Tangible Personal Property to Customers

Statutes: Sections 77.51(4)(a) and (b)2, 77.52(1), and 77.54(2) and (6)(b), Wis. Stats. (1991-92)

Wis. Adm. Code: Section Tax 11.15(7), March 1991 Register

Background: Section 77.54(6)(b), Wis. Stats. (1991-92), provides an exemption from Wisconsin sales and use tax for gross receipts from the sale of or the storage, use, or consumption of 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.

Section Tax 11.15(7), Wis. Adm. Code, provides that if a separate charge is made by a seller or lessor of tangible personal property to a customer for packaging materials used in connection with the shipment of the property, the charge for packaging materials becomes a part of the selling price or rental charge and is subject to Wisconsin sales or use tax.

Section 77.51(4)(a), Wis. Stats. (1991-92), defines "gross receipts" for purposes of imposing Wisconsin sales or use tax as the total amount of the sale, lease, or rental from retail sales of tangible personal property or taxable services, valued in money, whether received in money or otherwise.

Facts 1: Company ABC is a manufacturer of desks. Company ABC sells its desks to Company DEF, an insurance company, for use in its offices. The sale of the desks by Company ABC is subject to Wisconsin sales or use tax.

On the invoice, Company ABC separately charges Company DEF for packaging materials (e.g., pallets and separators) used in connection with the shipment of the desks.

Company ABC's shipping policy provides for a partial credit to be given to customers for pallets and separators returned to Company ABC. The credit is equal to 80% of the original packaging material charge.

Question 1a: Is the total charge (before 80% credit) by Company ABC to Company DEF for the packaging materials used in connection with the shipment of desks subject to Wisconsin sales or use tax?

Answer 1a: Yes. The charge for the packaging materials used to ship the desks by Company ABC to Company DEF is subject to Wisconsin sales or use tax. The charge for the packaging materials is part of the gross receipts from the sale of the desks, even though separately stated. Since the sale of the desks is subject to Wisconsin sales or use tax, any charge for packaging materials used to ship the desks is also subject to Wisconsin sales or use tax.

Question 1b: Is the sale of the packaging materials by a supplier to Com-

pany ABC subject to Wisconsin sales or use tax?

Answer 1b: No. Company ABC may purchase the shipping materials it transfers to its customers without Wisconsin sales tax under sec. 77.54(6)(b), Wis. Stats. (1991-92), provided it gives its supplier a properly completed exemption certificate.

Question 1c: May Company DEF claim exemption from Wisconsin sales or use tax under sec. 77.54(6)(b), Wis. Stats. (1991-92), on packaging materials transferred to it by Company ABC?

Answer 1c: No. Section 77.54(6)(b), Wis. Stats. (1991-92), provides that in order for the sale of packaging materials to be exempt from Wisconsin sales or use tax, the packaging materials must be used to transfer merchandise to the purchaser's customers. Because Company DEF is not using the packaging materials transferred to it by Company ABC to transfer merchandise to its own customers, the exemption under sec. 77.54(6)(b), Wis. Stats. (1991-92), does not apply.

Question 1d: What are the Wisconsin sales and use tax implications if Company DEF returns to Company ABC the packaging materials used in connection with the shipment of the desks?

Answer 1d: Under sec. 77.51(4)(b)2, Wis. Stats. (1991-92), Company ABC may take a deduction against its gross receipts, on line 8 of its sales and use tax return (Form ST-12), for the amount refunded to Company DEF as a result of the packaging materials being returned, provided Company ABC:

- Originally included such receipts on its sales and use tax return and paid the appropriate sales or use tax on those receipts.

- Returns to Company DEF the tax previously paid by Company DEF on the charge for packaging materials that is refunded.

Facts 2: Company GHI is a manufacturer of automobile parts. Company GHI sells these parts exclusively to automobile manufacturers, including Company XYZ. The sale of the parts by Company GHI is exempt from Wisconsin sales or use tax under sec. 77.54(2), Wis. Stats. (1991-92), as tangible personal property which becomes a component part of tangible personal property destined for sale.

Company GHI separately charges its customers for packaging materials (e.g., pallets and separators) used in connection with the shipment of the automobile parts.

Company GHI's shipping policy provides for a partial credit to be given to customers for pallets and separators returned to Company GHI. The credit is equal to 80% of the original packaging material charge.

Question 2a: Is the total charge (before 80% credit) by Company GHI to Company XYZ for the packaging materials used in connection with the shipment of automobile parts to Company XYZ subject to Wisconsin sales or use tax?

Answer 2a: No. The charge for the packaging materials used to ship the automobile parts by Company GHI to Company XYZ is not subject to Wisconsin sales or use tax. The charge for the packaging materials is part of the gross receipts from the sale of the automobile parts, even though separately stated. Therefore, the exemption for the sale of the automobile parts under sec. 77.54(2), Wis. Stats. (1991-92), applies to the charges for packaging materials used to ship the parts.

Question 2b: Is the sale of the packaging materials by a supplier to Company GHI subject to Wisconsin sales or use tax? •

Answer 2b: No. Company GHI may purchase the packaging materials it transfers to its customers without Wisconsin sales tax under sec. 77.54(6)(b), Wis. Stats. (1991-92), provided it gives its supplier a properly completed exemption certificate.

Question 2c: May Company XYZ claim exemption from Wisconsin sales or use tax under sec. 77.54(6)(b), Wis. Stats. (1991-92), on the charge for packaging materials transferred to it by Company GHI?

Answer 2c: No. Section 77.54(6)(b), Wis. Stats. (1991-92), provides that in order for the sale of packaging materials to be exempt from Wisconsin sales or use tax, the packaging materials must be used to transfer merchandise to the purchaser's customers. Because Company XYZ is not using the packaging materials transferred to it by Company GHI to transfer merchandise to its own customers, the exemption under sec. 77.54(6)(b), Wis. Stats. (1991-92), does not apply.

Question 2d: What are the Wisconsin sales and use tax implications if Company XYZ returns the packaging materials, used in connection with the shipment of the automobile parts, to Company GHI?

Answer 2d: Under sec. 77.51(4)(b)2, Wis. Stats. (1991-92), a deduction from gross receipts is allowed for returned merchandise. However, since Company GHI did not originally include the charge for packaging materials used to ship the automobile parts to Company XYZ in its receipts subject to Wisconsin sales and use tax, no deduction is allowed from gross receipts subject to sales tax when the packaging materials are

returned by Company XYZ to Company GHI. □

3 Shipping Materials — No Exemption for In-Transit Bracing Materials

Statutes: Section 77.54(6)(b), Wis. Stats. (1991-92)

Wis. Adm. Code: Section Tax 11.15, March 1991 Register

Background: Section 77.54(6)(b), Wis. Stats. (1991-92), provides an exemption from Wisconsin sales or use tax for gross receipts from the sale of and the storage, use, or consumption of 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. This section also provides an exemption from sales or use tax for gross receipts from the sale of and the storage, use, or consumption of meat casings, wrapping paper, tape, containers, labels, sacks, cans, boxes, drums, bags, or other packaging and shipping materials for use in packing, packaging, or shipping meat or meat products, regardless of whether such items are used to transfer merchandise to customers.

Section Tax 11.15(1)(b), Wis. Adm. Code, provides in part that packaging and shipping materials include property used inside a package to shape, form, preserve, stabilize, or protect contents, such as excelsior, straw, cotton, cardboard fillers, separators, shredded paper, ice, dry ice, and batting and rope, twine, gummed tape, wrapping paper, rubber bands, crates and crating materials, pallets, skids, and mailing tubes.

Section Tax 11.15(2), Wis. Adm. Code, provides in part that gross receipts from sales of the following are not exempt from sales tax under sec. 77.54(6)(b), Wis. Stats. (1991-92):

1. Containers or other packaging and shipping materials used merely for storage or to transfer merchandise owned by a person from one location to another, such as bakery delivery carts and containers used in delivering bakery products to retailers.
2. Lumber or other material used for bracing, blocking, skidding, or shoring items while in transit; and cardboard and paper used to line box cars.
3. Tanks on trucks used to deliver merchandise to customers.

Facts and Question 1: A paper manufacturer uses inflatable air bags along with blocks, pads, and void fillers made of honeycombed paper board to protect its paper products from damage when it ships them by rail car to its customers. When the paper products are removed from the rail car, these shipping materials either remain on the rail car or are discarded.

Do these shipping materials qualify for exemption from sales and use tax under sec. 77.54(6)(b), Wis. Stats. (1991-92)?

Answer 1: No. These shipping materials, while used in conjunction with transporting the merchandise, are not used to transfer merchandise to customers. In other words, the shipping materials remain on the rail cars or are discarded and are not transferred to the customer along with the merchandise.

Facts and Question 2: A food wholesaler uses bunkers charged

with CO₂ inside its trucks to keep foods, other than meat or meat products, frozen during delivery to grocery stores. The bunkers either stay on the trucks or are returned to the trucks after the food is delivered.

Do the bunkers and CO₂ qualify for exemption from sales and use tax under sec. 77.54(6)(b), Wis. Stats. (1991-92)?

Answer 2: No. The bunkers and CO₂, while used in conjunction with transporting the merchandise, are not used to transfer merchandise to customers. In other words, the bunkers and CO₂ remain on or are returned to the trucks and are not transferred to the customer along with the merchandise.

Note: If the bunkers and CO₂ were used for shipping meat or meat products, they would qualify for exemption under sec. 77.54(6)(b), Wis. Stats. (1991-92), because packaging or shipping materials for shipping meat qualify for exemption even if the materials are not used to transfer merchandise to customers. □

4 Telephone Company's Billing and Collection Services

Note: This tax release replaces the tax release by the same title that appeared in *Wisconsin Tax Bulletin 57* (July 1988), page 20.

Statutes: Sections 77.51(21m) and 77.52(2)(a)5, Wis. Stats. (1991-92)

Background: Effective October 1, 1991, 1991 Wisconsin Act 39 amended sec. 77.52(2)(a)5, Wis. Stats. (1989-90), and created sec. 77.51(21m), Wis. Stats., to read as follows:

Section 77.52(2)(a) 5, Wis. Stats.:

"The sale of telecommunications services, not including services paid for by the insertion of coins in a coin-operated telephone, that originate in this state and are charged to a service address in this state, regardless of the location where that charge is billed or paid."

Section 77.51(21m), Wis. Stats.:

"Telecommunications services' means sending messages and information transmitted through the use of local, toll and wide-area telephone service; channel services; telegraph services; teletypewriter; computer exchange services; cellular mobile telecommunications service; specialized mobile radio; stationary two-way radio; paging service; or any other form of mobile and portable one-way or two-way communications; or any other transmission of messages or information by electronic or similar means between or among points by wire, cable, fiber optics, laser, microwave, radio, satellite or similar facilities. 'Telecommunications services' does not include sending collect telecommunications that are received outside of the state."

Prior to October 1, 1991, sec. 77.52(2)(a)5, Wis. Stats. (1989-90), provided the following:

"The sale of telecommunication services of whatever nature, not including services paid for by the insertion of coins in a coin-operated telephone but including any services connected with the transmission of voice, sound, vision, information, data or material including connection, move and change charges; whether transmitted by wire,

microwave, satellite or other means; including interstate services originating in this state and charged to a subscriber or telephone located in this state.”

“Telecommunications services” was not defined in Chapter 77 of the Statutes prior to October 1, 1991.

Section 77.52(2)(a)5, Wis. Stats. (1989-90), was created by 1989 Wisconsin Act 31, which also repealed sec. 77.52(2)(a)4, Wis. Stats. (1987-88).

Facts and Question: A local telephone company provides billing and collection services for interexchange long-distance telecommunications carriers. This interexchange long-distance service is primarily interstate service, but also involves some intrastate service.

Are the gross receipts received by the local telephone company for providing billing and collection services to an interexchange long-distance telecommunication carrier subject to Wisconsin sales tax under sec. 77.52(2)(a)5, Wis. Stats.?

Answer:

Prior to October 1, 1991

Yes. Gross receipts received by the local telephone company for providing billing and collection services to an interexchange long-distance telecommunication carrier were subject to Wisconsin sales tax under sec. 77.52(2)(a)5, Wis. Stats. (1989-90). Billing and collection services are included within the broad title of “telecommunications services of whatever nature.”

October 1, 1991 and Thereafter

No. Gross receipts received by the local telephone company for provid-

ing billing and collection services to an interexchange long-distance telecommunication carrier are not subject to Wisconsin sales tax under sec. 77.52(2)(a)5, Wis. Stats. (1991-92). Billing and collection services are not included in the definition of “telecommunications services” as provided in sec. 77.51(21m), Wis. Stats. (1991-92). □

5 Towing Motor Vehicles

Statutes: Sections 77.52(2)(a)10 and 77.54(5)(a) and (b) and (9a)(b), Wis. Stats. (1991-92)

Wis. Adm. Code: Section Tax 11.49(1)(c), April 1993 Register and March 1991 Register

Background: Section 77.52(2)(a)10, Wis. Stats. (1991-92), provides that the towing of tangible personal property, including motor vehicles, is subject to Wisconsin sales or use tax, unless the following exception applies. An exception applies if the tangible personal property being towed would be exempt from sales tax if it were sold at the time of towing (e.g., motor vehicles owned by a Wisconsin governmental unit or owned by a common or contract carrier who uses the vehicle exclusively in common or contract carriage). This exception does not apply to motor vehicles or truck bodies sold to nonresidents which are exempt from Wisconsin sales or use tax under sec. 77.54(5)(a), Wis. Stats. (1991-92).

a. *Prior to May 1, 1993*

Prior to May 1, 1993, sec. Tax 11.49(1)(c), Wis. Adm. Code, provided that the towing of motor vehicles was subject to Wisconsin sales or use tax only if the towing was related to the repair, service, or maintenance of the vehicle. The

following towing services were not taxable:

1. Towing vehicles from “no parking” zones.
2. Towing a demolished vehicle to a junk yard.

b. *May 1, 1993 and Thereafter*

Effective May 1, 1993, sec. Tax 11.49(1)(c), Wis. Adm. Code, is revised to provide that the towing of a motor vehicle is taxable, unless an exemption applies. There are no requirements in sec. 77.52(2)(a), Wis. Stats. (1991-92), that the towing be related to the repair, service, and maintenance of the vehicle in order for the towing to be subject to Wisconsin sales or use tax.

The following examples illustrate the sales and use tax treatment of towing both prior to and on or after May 1, 1993.

Example 1: Company A operates a service station that offers towing service. Company A is contacted by Individual Z who indicates that his motor vehicle will not start. Company A tows Individual Z’s motor vehicle to its service station and repairs the motor vehicle. Company A charges \$30 for towing services provided.

a. *Prior to May 1, 1993*

The \$30 towing charge is subject to Wisconsin sales or use tax because it is related to the repair of a motor vehicle.

b. *May 1, 1993 and Thereafter*

The towing charge is subject to Wisconsin sales or use tax.

Example 2: Company B provides towing services. Company B does not provide repair services. Company B is contacted by Individual X who indicates that her motor vehicle will not start. Company B tows the motor vehicle to Company C, a service station, who will repair Individual X's motor vehicle. Company B charges Individual X \$30 for the towing services provided.

a. *Prior to May 1, 1993*

The \$30 towing charge is subject to Wisconsin sales or use tax because it is related to the repair of a motor vehicle.

b. *May 1, 1993 and Thereafter*

The towing charge is subject to Wisconsin sales or use tax.

Example 3: Company D, a towing company, has contracted with a Wisconsin county to tow vehicles abandoned or damaged on the county highways. The county contacts Company D and indicates that a vehicle has been abandoned on a highway. Company D tows the vehicle to its location until the owner is located and picks up the motor vehicle. The motor vehicle does not require repair. The owner of the motor vehicle pays Company D \$40 for the towing services provided.

a. *Prior to May 1, 1993*

The \$40 towing charge is not subject to Wisconsin sales or use tax because the towing is not related to the repair, service, or maintenance of a motor vehicle.

b. *May 1, 1993 and Thereafter*

The \$40 towing charge is subject to Wisconsin sales or use tax.

Example 4: Company E, a towing company, has contracted with a Wisconsin city to remove motor vehicles from "no parking" zones. Company E tows the motor vehicle to the city garage. Company E bills the city on a monthly basis for the towing services it provides. The owner of the motor vehicle pays a \$50 fine to the city and is allowed to claim his or her vehicle.

a. *Prior to May 1, 1993*

The city does not resell the towing service to the owners of towed motor vehicles. The city is the consumer of the towing service. However, the towing charge by Company E to the city is not subject to Wisconsin sales or use tax because it is a sale to a Wisconsin governmental unit. Sales to Wisconsin governmental units are exempt from Wisconsin sales or use tax under sec. 77.54(9a)(b), Wis. Stats. (1991-92).

b. *May 1, 1993 and Thereafter*

Same answer as given in Example 4, part a.

Example 5: Company F operates a service station. Company F is contacted by an insurance company to tow a damaged motor vehicle to Company F's service station and repair the motor vehicle. Company F charges the insurance company \$45 for the towing service provided.

a. *Prior to May 1, 1993*

The \$45 towing charge is subject to Wisconsin sales or use tax because it is related to the repair of a motor vehicle.

b. *May 1, 1993 and Thereafter*

The \$45 towing charge is subject to Wisconsin sales or use tax.

Example 6: Company G is a towing service provider. Company G is contacted by an insurance company to tow a damaged motor vehicle to a salvage yard for disposal. Company G charges the insurance company \$45 for the towing service provided.

a. *Prior to May 1, 1993*

The \$45 towing charge is not subject to Wisconsin sales or use tax because it is not related to the repair, service, or maintenance of a motor vehicle.

b. *May 1, 1993 and Thereafter*

The \$45 towing charge is subject to Wisconsin sales or use tax.

Example 7: Company H operates a service station. Company H is contacted by Common Carrier Y to tow Y's truck, which is used exclusively and directly in common carriage for hire, to the service station and repair the truck. Company H charges Common Carrier Y \$100 for towing service provided.

a. *Prior to May 1, 1993*

The \$100 towing charge is not subject to Wisconsin sales or use tax because at the time the truck is towed, if sold, it would have been exempt from Wisconsin sales or use tax under sec. 77.54(5)(b), Wis. Stats. (1991-92). Section 77.54(5)(b), Wis. Stats. (1991-92), provides an exemption from Wisconsin sales or use tax for motor trucks sold to common or contract carriers who use the trucks exclusively as common or contract carriers. Company H should obtain a properly completed exemption certificate from Common Carrier Y, in order to exempt the sale.

b. *May 1, 1993 and Thereafter*

Same answer as given in Example 7, part a.

Example 8: Company I provides towing service. Company I is contacted by Individual V, a nonresident of Wisconsin, to tow her damaged motor vehicle to a salvage yard for disposal. Company I charges Individual V \$30 to tow the motor vehicle.

a. *Prior to May 1, 1993*

The \$30 towing charge is not subject to Wisconsin sales or use tax because it is not related to the repair, service, or maintenance of a motor vehicle.

b. *May 1, 1993 and Thereafter*

The \$30 towing charge is subject to Wisconsin sales or use tax. Although the motor vehicle at the time of towing is exempt from Wisconsin tax if sold for immediate removal from Wisconsin, sec. 77.52(2)(a)10, Wis. Stats. (1991-92) specifically excludes from exemption, towing of motor vehicles exempt from sales and use tax under sec. 77.54(5)(a), Wis. Stats. (1991-92).

Example 9: Company J provides towing services. Company J does not provide repair services. Company J is contacted by Individual U who indicates that his motor vehicle will not start. Company J tows the motor vehicle to Company K, a service station, who will repair Individual U's motor vehicle. Company J charges Company K \$30 for the towing services provided. Company K charges Individual U \$40 for the towing service provided.

a. *Prior to May 1, 1993*

The \$40 towing charge by Company K to Individual U is subject to Wisconsin sales or use tax because it is related to the repair of a motor vehicle. The \$30 charge for towing by Company J to Company K is not subject to Wisconsin sales or use tax, provided Company K gives Company J a properly completed resale certificate.

b. *May 1, 1993 and Thereafter*

The \$40 towing charge by Company K to Individual U is subject to Wisconsin sales or use tax. The \$30 charge for towing by Company J to Company K is not subject to Wisconsin sales or use tax, provided Company K gives Company J a properly completed resale certificate. ☐

TEMPORARY RECYCLING SURCHARGE

6 Application of the Temporary Recycling Surcharge to Partnerships

Statutes: Sections 77.92(4) and (5), 77.93(3) and (5), and 77.94(1)(b) and (c), Wis. Stats. (1991-92)

Note: The temporary recycling surcharge applies for taxable years ending after April 1, 1991, and ending before April 1, 1999. This tax release supersedes the instructions to the 1991 Form 3S, Wisconsin Partnership Temporary Surcharge, and the information with respect to partnerships in Part IV of the December 1991 edition of Publication 400, *Wisconsin's Temporary Surcharge*. Except where indicated below, the tax release applies for taxable years ending after April 1, 1991.

Definitions

In this tax release, the following definitions apply:

Farming — "Farming" is the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity including the raising, shearing, feeding, caring for, training, and management of animals. Trees, other than trees bearing fruit or nuts, are not treated as an agricultural or horticultural commodity. Raising or harvesting Christmas trees is not considered farming.

Gross Receipts — For taxable years beginning on or after January 1, 1992, "gross receipts" are the total receipts or sales from all trade or business activities, *except farming*, reportable for federal income tax purposes, before deducting returns and allowances or any other business expenses. Gross receipts include:

- gross receipts or sales reportable on 1992 federal Form 1065, U.S. Partnership Return of Income, line 1a,
- gross receipts (except farm receipts) passed through from other partnerships and fiduciaries and includable in computing the amount on federal Form 1065, line 4,
- the gross sales price from the sale or disposition of business assets (except farm assets) includable in computing the net gain or loss on federal Form 1065, line 6, and
- other gross receipts includable in computing other income or loss on federal Form 1065, line 7.

For taxable years beginning before January 1, 1992, "gross receipts" are the total receipts or sales from

all trade or business activities, *including farming*, reportable for federal income tax purposes, before deducting returns and allowances or any other business expenses. Gross receipts include:

- gross receipts or sales reportable on 1991 federal Form 1065, U.S. Partnership Return of Income, line 1a,
- gross receipts (including farm receipts) passed through from other partnerships and fiduciaries and includable in computing the amount on federal Form 1065, line 4,
- gross receipts from farming includable in computing the net farm profit or loss on federal Form 1065, line 5,
- the gross sales price from the sale or disposition of business assets (including farm assets) includable in computing the net gain or loss on federal Form 1065, line 6, and
- other gross receipts includable in computing other income or loss on federal Form 1065, line 7.

Net Business Income — *For taxable years beginning on or after January 1, 1992*, “net business income” is the ordinary income or loss from all trade or business activities, *except farming*, reportable for Wisconsin income tax purposes. Generally, this is the amount reportable on 1992 Wisconsin Form 3, Wisconsin Partnership Return, Schedule 3K, line 1, column d, but excluding ordinary income or losses from farming. This is the ordinary income or loss from trade or business activities computed on 1992 federal Form 1065, U.S. Partnership Return of Income, line 22, as adjusted for certain differences between federal and Wisconsin

law, but *before application of apportionment or separate accounting*.

For taxable years beginning before January 1, 1992, “net business income” is the ordinary income or loss from all trade or business activities, *including farming*, reportable for Wisconsin income tax purposes. Generally, this is the amount reportable on 1991 Wisconsin Form 3, Wisconsin Partnership Return, Schedule 3K, line 1, column d, including ordinary income or losses from farming. This is the ordinary income or loss from trade or business activities computed on 1991 federal Form 1065, U.S. Partnership Return of Income, line 22, as adjusted for certain differences between federal and Wisconsin law, but *before application of apportionment or separate accounting*.

Net Farm Profit — “Net farm profit” is all farm income less all farm expenses for federal income tax purposes. It includes:

- net farm profit or loss from federal Schedule F, Profit or Loss From Farming, reported on 1992 federal Form 1065, U.S. Partnership Return of Income, line 5, and
- ordinary gain or loss on the disposition of farm assets from federal Form 4797, Sales of Business Property, reported on 1992 federal Form 1065, line 6.

Trade or Business — “Trade or business” has the meaning given in section 162 of the Internal Revenue Code. A trade or business is an activity regularly carried on by the partnership with the intention of making a profit.

Questions and Answers

Question 1: Which partnerships are subject to the temporary recycling surcharge?

Answer 1: The temporary recycling surcharge applies to every partnership that must file a Wisconsin partnership return, Form 3, and whose receipts or profits from trade or business activities exceed certain minimums, as described below:

- Partnerships which are not engaged in farming and have at least \$1,000 of gross receipts from trade or business activities for federal income tax purposes.
- Partnerships which are engaged solely in farming and have at least \$1,000 of net farm profit for federal income tax purposes.
- *For taxable years beginning on or after January 1, 1992*, partnerships which are engaged in farming and other trade or business activities and have at least \$1,000 of gross receipts from all nonfarm trade or business activities for federal income tax purposes *or* at least \$1,000 of net farm profit.
- *For taxable years beginning before January 1, 1992*, partnerships which are engaged in farming and other trade or business activities and have at least \$1,000 of gross receipts from all trade or business activities, including farming, for federal income tax purposes *or* at least \$1,000 of net farm profit.

The following examples illustrate partnerships that are subject to the temporary recycling surcharge.

A. Partnerships Engaged in Business Other Than Farming

Example 1: Partnership A, which is not engaged in farming, reports the following amounts on its 1992 federal Form 1065:

Gross receipts or sales (line 1a)	\$ 1,000
Less returns and allowances (line 1b)	100

Partnership A is subject to the temporary recycling surcharge because its gross receipts are at least \$1,000 before any reduction for returns and allowances.

Example 2: Partnership B, which is not engaged in farming, reports the following amounts on its 1992 federal Form 1065:

Gross receipts or sales (line 1a)	\$ 900
Ordinary income from other partnerships (line 4) *	100,000

* Gross receipts from the trade or business activities of the other partnerships are \$500,000.

Partnership B is subject to the temporary recycling surcharge because its gross receipts of \$500,900 (\$900 + \$500,000) are at least \$1,000.

Example 3: Partnership C, which was organized for investment purposes only, is engaged in the rental of real estate. During 1992, Partnership C sells the property and reports the following amount on its 1992 federal Form 1065:

Net gain from Form 4797 (line 6) *	\$ 4,000
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* The gross sales price of the assets is \$50,000.

Partnership C reports the following amounts on its 1992 Wisconsin Form 3, Schedule 3K, column d:

Ordinary income from trade or business activities (line 1)	\$ 4,000
Net income from rental real estate activities (line 2)	3,000

Net gain under section 1231 (line 6)	55,000
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Partnership C is subject to a temporary recycling surcharge based on the net gain from the sale of assets reportable as ordinary income on federal Form 4797, Part II, because its gross receipts of \$50,000 are at least \$1,000. (Note: The surcharge does not apply to Partnership C's rental income or section 1231 gain.)

B. Partnerships Engaged Solely in Farming

Example: Partnership A is engaged only in farming. It reports the following amounts on its 1992 federal Form 1065:

Net farm profit (line 5)	\$ 900
Net gain from Form 4797 (line 6)	5,000

Partnership A is subject to the temporary recycling surcharge because its net farm profit for purposes of the surcharge of \$5,900 (\$900 + \$5,000) is at least \$1,000.

C. Partnerships Engaged in Farming and Another Trade or Business

Example 1: Partnership A is engaged in farming, but also has trade or business income from repairing engines. Partnership A reports the following amounts on its 1992 federal Form 1065:

Gross receipts or sales (line 1a)	\$ 1,500
Net farm profit (line 5)	900

Partnership A is subject to a temporary recycling surcharge based on the net business income from its engine repair business because it has at least \$1,000 of gross receipts from that business. Partnership A is not subject to the surcharge on its farming operation since its net farm profit for pur-

poses of the surcharge is less than \$1,000.

Example 2: Partnership B is engaged in farming, but also has trade or business income from selling cleaning supplies. Partnership B reports the following amounts on its 1991 federal Form 1065:

Gross receipts or sales (line 1a)	\$ 500
Net farm profit (line 5) *	900

* Gross receipts from farming are \$2,000.

Partnership B is subject to a temporary recycling surcharge because its total gross receipts of \$2,500 (\$2,000 from its farming operation and \$500 from its other business activity of selling cleaning supplies) are at least \$1,000. (Note: Assuming the same facts for 1992, Partnership B would not be subject to the surcharge.)

Question 2: Which partnerships are not subject to the temporary recycling surcharge?

Answer 2: The temporary recycling surcharge does not apply to:

- Partnerships that are not required to file a Wisconsin partnership return, Form 3. Syndicates, pools, joint ventures, or similar organizations that have elected not to be treated as partnerships under section 761(a) of the Internal Revenue Code and as a result are not required to file a partnership return are not subject to the temporary recycling surcharge.
- Partnerships which are not engaged in farming and have less than \$1,000 of gross receipts from all trade or business activities for federal income tax purposes.

- Partnerships which are engaged solely in farming and have less than \$1,000 of net farm profit for federal income tax purposes.
- *For taxable years beginning on or after January 1, 1992*, partnerships which are engaged in both farming and other trade or business activities and have less than \$1,000 of gross receipts from all nonfarm trade or business activities for federal income tax purposes *and* less than \$1,000 of net farm profit for federal income tax purposes.
- *For taxable years beginning before January 1, 1992*, partnerships which are engaged in both farming and other trade or business activities and have less than \$1,000 of gross receipts from all trade or business activities, including farming, for federal income tax purposes *and* less than \$1,000 of net farm profit for federal income tax purposes

Following are examples of partnerships that are not subject to the temporary recycling surcharge.

A. Partnerships Not Required to File Wisconsin Form 3

Example 1: Partnership A does not do any business in Wisconsin, perform personal or professional services in Wisconsin, or receive income from real or tangible personal property in Wisconsin. Partnership A has three partners who are Wisconsin residents.

Partnership A is not subject to the temporary recycling surcharge because it is not required to file a Wisconsin partnership return, Form 3.

Example 2: Assume the same facts as in Example 1, except that the department requests Partnership A to file Wisconsin Form 3 to verify the

income of the three partners who are residents of Wisconsin.

Partnership A is not subject to the temporary recycling surcharge because the partnership is filing Wisconsin Form 3 only to verify the income of the Wisconsin resident partners.

Example 3: Partnership B, which was organized for investment purposes only and is not a dealer or trader in securities, derives income from interest, dividends, and capital gains on the disposition of securities. Partnership B elects under IRC sec. 761(a) not to be treated as a partnership for federal income tax purposes because it was organized for investment purposes only and not for the active conduct of a trade or business. Partnership B makes a similar election for Wisconsin purposes on its 1992 Wisconsin Form 3. Therefore, it does not file federal Form 1065 or Wisconsin Form 3 for any subsequent years.

Partnership B is not subject to the temporary recycling surcharge because it is not required to file a Wisconsin partnership return.

Example 4: Partnership C is at least 51% owned and controlled by American Indians who are enrolled members of the same tribe. The partnership is engaged in business only on the tribal reservation of its partners. Partnership C does not file a 1992 Wisconsin partnership return since it has no business activities in Wisconsin off the reservation.

Partnership C is not subject to the temporary recycling surcharge because it is not required to file a Wisconsin partnership return.

B. Partnerships Engaged in Business Other Than Farming

Example 1: Partnership A, which was organized for investment purposes

only and is not a dealer or trader in securities, reports no income, losses, or deductions on its 1992 federal Form 1065, lines 1 through 22. Partnership A reports the following amounts on its 1992 Wisconsin Form 3, Schedule 3K, column d:

Interest income (line 4a)	\$ 1,000
Dividend income (line 4b)	2,000
Net long-term capital gain (line 4e)	5,000

Partnership A is not subject to the temporary recycling surcharge because it does not have at least \$1,000 of gross receipts from trade or business activities.

Example 2: Partnership B, which was organized for investment purposes only and is not a dealer or trader in real estate, reports no income, losses, or deductions on its 1992 federal Form 1065, lines 1 through 22. Partnership B reports the following amounts on its 1992 Wisconsin Form 3, Schedule 3K, column d:

Net income from rental real estate activities (line 2)	\$ 1,000
Interest income (line 4a)	250
Net long-term capital gain (line 4e)	5,000

Partnership B is not subject to the temporary recycling surcharge because it does not have at least \$1,000 of gross receipts from trade or business activities.

C. Partnerships Engaged Solely in Farming

Example: Partnership A is engaged solely in farming. It reports the following amounts on its 1992 federal Form 1065:

Net farm profit (line 5)	\$ 1,500
Net gain from Form 4797 (line 6)	(600)

Partnership A is not subject to the temporary recycling surcharge because its net farm profit for purposes of the surcharge of \$900 (\$1,500 - \$600) is less than \$1,000.

D. Partnerships Engaged in Farming and Another Trade or Business

Example: Partnership A is engaged in farming, but also has trade or business income from selling cleaning supplies. Partnership A reports the following amounts on its 1992 federal Form 1065:

Gross receipts or sales (line 1a)	\$	500
Net farm profit (line 5) *		900

* Gross receipts from farming are \$2,000.

Partnership A is not subject to a temporary recycling surcharge for 1992 based on the net business income from its cleaning supplies business because it does not have at least \$1,000 of gross receipts from that business. Partnership A is not subject to the surcharge on its farming operation since its net farm profit is less than \$1,000. (Note: Assuming the same facts for 1991, Partnership A would have been subject to the surcharge.)

Question 3: How do partnerships compute the temporary recycling surcharge?

Answer 3: Partnerships compute the temporary recycling surcharge as described in the sections that follow.

A. Partnerships Engaged in Business Other Than Farming

The temporary recycling surcharge is the greater of

- \$25, or

- the amount computed by multiplying the partnership's net business income, as allocated or apportioned to Wisconsin, by 0.4345% (.004345), but not more than \$9,800.

The following examples illustrate the computation of the temporary recycling surcharge for partnerships that are not engaged in farming.

Example 1: Partnership A, which is doing business only in Wisconsin, reports the following amounts on its 1992 Wisconsin Form 3, Schedule 3K, column d:

Ordinary income from trade or business activities (line 1)	\$ 200,000
Net loss from rental real estate activities (line 2)	(5,000)
Interest income (line 4a)	10,000
Net short-term capital gain (line 4d)	3,000
Net long-term capital gain (line 4e)	2,000
Guaranteed payments to partners (line 5)	15,000
Net gain under section 1231 (line 6)	1,000
Charitable contributions (line 8)	5,000
Section 179 expense deduction (line 9)	6,000
Deductions related to portfolio income (line 10)	1,000
Interest expense on investment debts (line 12a)	2,000
State and municipal bond interest (line 16)	1,000

Partnership A's net business income is \$200,000, which is its ordinary income from trade or business activities reported on Wisconsin Form 3, Schedule 3K, line 1, column d. Therefore, Partnership A is subject to a temporary recycling surcharge of \$869 (\$200,000 x .004345).

Example 2: Assume the same facts as in Example 1, except that Partnership A reports a \$20,000 ordinary loss from trade or business activities on its 1992 Wisconsin Form 3, Schedule 3K, line 1, column d. Partnership A has a net business loss of \$20,000.

Partnership A is subject to a temporary recycling surcharge of \$25. Although Partnership A has a net business loss, the minimum surcharge of \$25 applies.

Example 3: Assume the same facts as in Example 1, except that Partnership A reports \$3,000,000 of ordinary income from trade or business activities on its 1992 Wisconsin Form 3, Schedule 3K, line 1, column d. Partnership A's net business income is \$3,000,000.

Partnership A is subject to a temporary recycling surcharge of \$9,800. Although Partnership A computes a surcharge of \$13,035 (\$3,000,000 x .004345), the maximum surcharge of \$9,800 applies.

Example 4: Partnership B, which is doing business only in Wisconsin, reports the following amounts on its 1992 federal Form 1065:

Ordinary income from other partnerships (line 4)	\$ 100,000
Total deductions (line 21)	(20,000)
Ordinary income from trade or business activities (line 22)	<u>\$ 80,000</u>

Partnership B reports the following amounts on its 1992 Wisconsin Form 3, Schedule 3K, column d:

Ordinary income from trade or business activities (line 1)	\$ 80,000
Interest income (line 4a)	10,000
Other portfolio income (line 4f)	5,000

Deductions relating to
portfolio income
(line 10) 1,000

Partnership B's net business income is \$80,000, which is the ordinary income from trade or business activities reported on Wisconsin Form 3, Schedule 3K, line 1, column d. Partnership B's net business income includes its distributive share of trade or business income from another partnership, even though that partnership is also subject to the surcharge on the income. Therefore, Partnership B is subject to a temporary recycling surcharge of \$348 ($\$80,000 \times .004345$).

Example 5: Partnership C, which is doing business only in Wisconsin, derives income from the rental of tangible personal property and reports \$15,000 of net income from other rental activities on its 1992 Wisconsin Form 3, Schedule 3K, line 3, column d.

Partnership C's net business income is \$15,000, which is its ordinary income from the rental of tangible personal property reported on Wisconsin Form 3, Schedule 3K, line 3, column d. Therefore, Partnership A is subject to a temporary recycling surcharge of \$65 ($\$15,000 \times .004345$).

Example 6: Partnership D is at least 51% owned and controlled by American Indians who are enrolled members of the same tribe. It is engaged in business both on and off the tribal reservation of its partners. For 1992, Partnership D earns \$30,000 of net income, of which \$12,000 is attributable to business activities in Wisconsin off the reservation. Partnership D must file a Wisconsin partnership return since it is doing business in Wisconsin off the reservation.

Partnership D is subject to a temporary recycling surcharge of \$52 ($\$12,000 \times .004345$).

B. Partnerships Engaged Solely in Farming

For partnerships engaged solely in farming and having at least \$1,000 of net farm profit for federal income tax purposes, the temporary recycling surcharge is \$25.

Example 1: Partnership A is engaged in dairy farming. Partnership A reports the following amounts on its 1992 federal Form 1065:

Net farm profit (line 5)	\$ 100,000
Net gain from Form 4797 (line 6)	30,000

Partnership A reports the following amounts on its 1992 Wisconsin Form 3, Schedule 3K, column d:

Ordinary income from trade or business activities (line 1)	\$ 130,000
Interest income (line 4a)	1,000

Partnership A is subject to a temporary recycling surcharge of \$25. A \$25 temporary recycling surcharge applies to partnerships engaged solely in farming and having net farm profit of \$1,000 or more.

Example 2: Assume the same facts as in Example 1, except that Partnership A operates two separate farms.

Partnership A is subject to a temporary recycling surcharge of \$25, regardless of the number of farms it operates, assuming its combined net farm profit is at least \$1,000.

C. Partnerships Engaged in Farming and Another Trade or Business

1. Taxable years beginning on or after January 1, 1992

For taxable years beginning on or after January 1, 1992, the temporary recycling surcharge for a partnership that is engaged in farming and another trade or business is the sum of the following amounts:

- the greater of \$25 or the amount computed by multiplying the partnership's net business income (other than from farming), as allocated or apportioned to Wisconsin, by 0.4345% (.004345), but not more than \$9,800, plus
- \$25, if the net farm profit is at least \$1,000.

The following examples illustrate the computation of the temporary recycling surcharge for partnerships that are engaged in both farming and other trade or business activities in taxable years beginning on or after January 1, 1992.

Example 1: Partnership A is engaged in farming and in the business of selling farm supplies. Partnership A reports the following amounts on its 1992 federal Form 1065:

Gross receipts or sales (line 1a)	\$ 200,000
Cost of goods sold (line 2)	(70,000)
Gross profit (line 3)	\$ 130,000
Net farm profit (line 5)	90,000
Net gain from Form 4797 (line 6) *	5,000
Total income (line 8)	\$ 225,000
Total deductions (line 21)	(125,000)
Ordinary income from trade or business activities (line 22)	\$ 100,000

* The gain is from the sale of nonfarm business assets.

Partnership A reports the following amounts on its 1992 Wisconsin Form 3, Schedule 3K, column d:

Ordinary income from trade or business activities (line 1)	\$ 100,000
Interest income (line 4a)	5,000
Net long-term capital gain (line 4e)	4,000
Charitable contributions (line 8)	3,000
Other deductions (line 11)	1,000
Interest expense on investment debts (line 12a)	1,000

Partnership A's net business income is \$10,000, which is its ordinary income from trade or business activities reported on Wisconsin Form 3, Schedule 3K, line 1, column d, minus its net farm profit from federal Form 1065, line 5. Partnership A is subject to a temporary recycling surcharge of \$69, computed as follows:

Surcharge for all nonfarm trade or business activities (\$10,000 x .004345)	\$ 44
Surcharge for farming	25
Total temporary recycling surcharge	<u>\$ 69</u>

Example 2: Partnership B is engaged in farming and in the business of trucking. Partnership B reports the following amounts on its 1992 federal Form 1065:

Gross receipts or sales (line 1a)	\$ 1,200
Cost of goods sold (line 2)	(0)
Gross profit (line 3)	\$ 1,200
Net farm profit (line 5)	500
Net gain from Form 4797 (line 6) *	5,000
Total income (line 8)	\$ 6,700
Total deductions (line 21)	(5,900)
Ordinary income from trade or business activities (line 22)	<u>\$ 800</u>

* The gain is from the sale of farm assets.

Partnership B reports the following amounts on its 1992 Wisconsin Form 3, Schedule 3K, column d:

Ordinary income from trade or business activities (line 1)	\$ 800
Royalty income (line 4c)	1,000
Net short-term capital gain (line 4d)	5,000
Charitable contributions (line 8)	500
Other deductions (line 11)	1,000

Partnership B has a net business loss of \$4,700, which is the ordinary income from trade or business activities reported on Wisconsin Form 3, Schedule 3K, line 1, column d, minus the net farm profit. Partnership B is subject to a temporary recycling surcharge of \$50, computed as follows:

Surcharge for trucking business	\$ 25
Surcharge for farming	25
Total temporary recycling surcharge	<u>\$ 50</u>

Partnership B is subject to the temporary recycling surcharge on its nonfarm trade or business activities because its \$1,200 of gross receipts from nonfarm trade or business activities are at least \$1,000.

In addition, Partnership B is subject to the \$25 temporary recycling surcharge on the farming operation because its \$5,500 net farm profit, which includes the ordinary gain from the sale of a farm asset, is at least \$1,000.

Example 3: Partnership C is engaged in both farming and mining. It has net business income of \$25,000 from its mining business and a net farm loss of \$20,000.

Partnership C is subject to a temporary recycling surcharge of \$109 (\$25,000 x .004345) on the net business income from its mining business.

It is not subject to a surcharge on its farming operation.

Note: Partnership C cannot reduce its net business income from nonfarm trade or business activities by the amount of its net farm loss.

2. Taxable years beginning before January 1, 1992

For taxable years beginning before January 1, 1992, the temporary recycling surcharge for a partnership that is engaged in farming and another trade or business is the sum of the following amounts:

- the greater of \$25 or the amount computed by multiplying the partnership's net business income (including income or loss from farming), as allocated or apportioned to Wisconsin, by 0.4345% (.004345), but not more than \$9,800, plus
- \$25, if the net farm profit is at least \$1,000.

The following examples illustrate the computation of the temporary recycling surcharge for partnerships that are engaged in both farming and other trade or business activities in taxable years beginning before January 1, 1992.

Example 1: Partnership A is engaged in farming and in the business of selling farm supplies. Partnership A reports the following amounts on its 1991 federal Form 1065:

Gross receipts or sales (line 1a)	\$ 200,000
Cost of goods sold (line 2)	<u>(70,000)</u>
Gross profit (line 3)	\$ 130,000
Net farm profit (line 5)	90,000
Net gain from Form 4797 (line 6) *	<u>5,000</u>
Total income (line 8)	\$ 225,000
Total deductions (line 21)	<u>(125,000)</u>
Ordinary income from trade or business activities (line 22)	<u>\$ 100,000</u>

* The gain is from the sale of nonfarm business assets.

Partnership A reports the following amounts on its 1991 Wisconsin Form 3, Schedule 3K, column d:

Ordinary income from trade or business activities (line 1)	\$ 100,000
Interest income (line 4a)	5,000
Net long-term capital gain (line 4e)	4,000
Charitable contributions (line 8)	3,000
Other deductions (line 11)	1,000
Interest expense on investment debts (line 12a)	1,000

Partnership A's net business income is \$100,000, which is its ordinary income from all trade or business activities, including farming, reported on Wisconsin Form 3, Schedule 3K, line 1, column d. Partnership A is subject to a temporary recycling surcharge of \$460, computed as follows:

Surcharge for all trade or business activities (\$100,000 x .004345)	\$ 435
Surcharge for farming	<u>25</u>
Total temporary recycling surcharge	<u>\$ 460</u>

Example 2: Partnership B is engaged in farming and in the business of trucking. Partnership B reports

the following amounts on its 1991 federal Form 1065:

Gross receipts or sales (line 1a)	\$ 1,200
Cost of goods sold (line 2)	<u>(0)</u>
Gross profit (line 3)	\$ 1,200
Net farm profit (line 5) *	500
Net gain from Form 4797 (line 6) *	<u>5,000</u>
Total income (line 8)	\$ 6,700
Total deductions (line 21)	<u>(5,900)</u>
Ordinary income from trade or business activities (line 22)	<u>\$ 800</u>

* Gross receipts from farming are \$30,000; the gain is from the sale of farm assets.

Partnership B reports the following amounts on its 1991 Wisconsin Form 3, Schedule 3K, column d:

Ordinary income from trade or business activities (line 1)	\$ 800
Royalty income (line 4c)	1,000
Net short-term capital gain (line 4d)	5,000
Charitable contributions (line 8)	500
Other deductions (line 11)	1,000

Partnership B has net business income of \$800, which is the ordinary income from all trade or business activities, including farming, reported on Wisconsin Form 3, Schedule 3K, line 1, column d. Partnership B is subject to a temporary recycling surcharge of \$50, computed as follows:

Surcharge for trucking business	\$ 25
Surcharge for farming	<u>25</u>
Total temporary recycling surcharge	<u>\$ 50</u>

Partnership B is subject to the temporary recycling surcharge on all trade or business activities because its \$31,200 of gross receipts from all

trade or business activities, including farming, are at least \$1,000.

In addition, Partnership B is subject to the \$25 temporary recycling surcharge on the farming operation because its \$5,500 net farm profit, which includes the ordinary gain from the sale of a farm asset, is at least \$1,000.

Example 3: Partnership C is engaged in both farming and mining. It has ordinary income of \$25,000 from its mining business and a net farm loss of \$20,000. Partnership C reports \$5,000 of ordinary income from trade or business activities on its 1991 Wisconsin Form 3, Schedule 3K, line 1, column d.

Partnership C has net business income of \$5,000, which is the ordinary income from all trade or business activities, including farming, reported on Wisconsin Form 3, Schedule 3K, line 1, column d.

Partnership C is subject to a temporary recycling surcharge of \$25 (the greater of \$25 or \$22 [\$5,000 x .004345]) on the net business income from its mining business.

D. Multistate Partnerships

If a partnership is engaged in business in and outside Wisconsin, the temporary recycling surcharge is computed as follows:

- If the partnership is not engaged in farming, the surcharge is the greater of \$25 or the amount computed by multiplying the partnership's net business income, as allocated or apportioned to Wisconsin, by 0.4345% (.004345), but not more than \$9,800.
- If the partnership is engaged solely in farming and has at least \$1,000 of net farm profit for

federal income tax purposes, the surcharge is \$25.

- *For taxable years beginning on or after January 1, 1992*, if the partnership is engaged in farming and other trade or business activities, the surcharge is the sum of

(a) the greater of \$25 or the amount computed by multiplying the partnership's net business income (other than from farming), as allocated or apportioned to Wisconsin, by 0.4345% (.004345), but not more than \$9,800, plus

(b) \$25, if the net farm profit is at least \$1,000.

- *For taxable years beginning before January 1, 1992*, if the partnership is engaged in farming and other trade or business activities, the surcharge is the sum of

(a) the greater of \$25 or the amount computed by multiplying the partnership's net business income from all trade or business activities, including farming, as allocated or apportioned to Wisconsin, by 0.4345% (.004345), but not more than \$9,800, plus

(b) \$25, if the net farm profit is at least \$1,000.

Note: Neither the \$25 minimum surcharge nor the \$9,800 maximum surcharge are multiplied by the partnership's Wisconsin apportionment percentage.

Example 1: Partnership A is engaged in business in and outside Wisconsin. Partnership A is not engaged in farming. It reports the

following amounts on its 1992 Wisconsin Form 3, Schedule 3K, column d:

Ordinary income from trade or business activities (line 1)	\$ 40,000
Dividend income (line 4b)	10,000
Net long-term capital gain (line 4e)	15,000
Other deductions (line 11)	5,000

Partnership A computes an apportionment percentage of 60% on 1992 Wisconsin Form 4B, line 28.

Partnership A's net business income is \$40,000, which is the ordinary income from trade or business activities reported on Wisconsin Form 3, Schedule 3K, line 1, column d. Partnership A is subject to a temporary recycling surcharge of \$104 $[(\$40,000 \times 60\%) \times .004345]$.

Example 2: Assume the same facts as in Example 1, except that Partnership A reports a \$100,000 ordinary loss from trade or business activities on its 1992 Wisconsin Form 3, Schedule 3K, line 1, column d.

Partnership A is subject to the minimum temporary recycling surcharge of \$25 since it has a net business loss of \$100,000.

Note: The minimum temporary surcharge is not multiplied by Partnership A's apportionment percentage.

Example 3: Assume the same facts as in Example 1, except that Partnership A reports \$4,000,000 of ordinary income from trade or business activities on its 1992 Wisconsin Form 3, Schedule 3K, line 1, column d.

Partnership A is subject to a temporary recycling surcharge of \$9,800. Although Partnership A computes a surcharge of \$10,428 $[(\$4,000,000 \times 60\%) \times .004345]$, the maximum

temporary recycling surcharge of \$9,800 applies.

Note: The maximum temporary recycling surcharge of \$9,800 is not multiplied by Partnership A's apportionment percentage.

Example 4: Partnership B is engaged solely in farming in and outside Wisconsin. Partnership B reports \$50,000 of net farm profit on its 1992 federal Form 1065, line 5. Partnership B has no other income or loss. Partnership B computes an apportionment percentage of 30% on 1992 Wisconsin Form 4B, line 28.

Partnership B is subject to a temporary recycling surcharge of \$25, the surcharge applicable to a partnership engaged solely in farming.

Note: The \$25 temporary recycling surcharge for farming is not multiplied by the apportionment percentage. □

7 Temporary Recycling Surcharge — Individual Retirement Arrangements

Statutes: Sections 77.92(4), 77.93(2) and (5), and 77.94(1)(b), Wis. Stats. (1991-92)

Note: The temporary recycling surcharge applies to taxable years ending after April 1, 1991, and ending before April 1, 1999. This tax release supersedes the information relating to tax-exempt trusts in the 1991 instructions to Wisconsin Form 4T, Wisconsin Exempt Organization Business Franchise or Income Tax Return, and in the December 1991 edition of Publication 400, *Wisconsin's Temporary Surcharge*. The tax release applies retroactively to taxable years ending after April 1, 1991.

Background:

Federal Law: Individuals may establish personal savings plans, called individual retirement arrangements (IRAs), which offer tax advantages to set aside money for retirement. IRAs may be set up with various types of organizations, including banks and other financial institutions, mutual funds, and life insurance companies. IRAs can be individual retirement accounts or individual retirement annuities, or they can be part of either a simplified employee pension of an employer or an employer or employee association trust account. Funds in an IRA may be invested in a variety of ways, including stocks, government bonds, savings accounts, certificates of deposits, annuities, participations in common trust funds, partnerships, and real estate.

Generally, IRAs are exempt from federal income taxes other than the tax imposed under sec. 511 of the Internal Revenue Code (IRC) on unrelated business taxable income. IRC sec. 408(e)(1). Unrelated business taxable income is income from a trade or business regularly carried on by the IRA which is not substantially related to the exercise by the IRA of its tax-exempt purpose. It includes income from a trade or business carried on by a partnership of which the IRA is a member. IRC secs. 512(c) and 513(b).

Excluded from unrelated business taxable income are dividends, interest, annuities, royalties, certain rents, and gains or losses from the sale, exchange, or other disposition of property other than inventory or property held in the course of a trade or business. IRC sec. 512(b).

An IRA which has \$1,000 or more of gross income from an unrelated trade or business must file federal Form 990-T, Exempt Organization Business Income Tax Return.

Wisconsin Law: Trusts exempt from federal income tax are to the same extent exempt from Wisconsin income tax. Sec. 71.17(5), Wis. Stats. (1991-92). Trusts that have \$1,000 or more of gross income from an unrelated trade or business and must file federal Form 990-T are required to file Wisconsin Form 4T, Wisconsin Exempt Organization Business Franchise or Income Tax Return.

Wisconsin Temporary Recycling Surcharge Law: Trusts that must file a Wisconsin income tax return and that have a profit or loss, for federal income tax purposes, from a trade or business are subject to the temporary recycling surcharge. Sec. 77.93(2), Wis. Stats. (1991-92).

The temporary recycling surcharge for trusts, except those engaged only in farming, is equal to the greater of \$25 or 0.4345% of net business income, but not more than \$9,800. Sec. 77.94(1)(b), Wis. Stats. (1991-92).

Trusts engaged in farming are subject to a temporary recycling surcharge of \$25, if they have a net farm profit of at least \$1,000. Sec. 77.93(5) and 77.94(1)(c), Wis. Stats. (1991-92).

Facts and Question: Taxpayer X has an IRA which invests funds in real estate limited partnerships. The partnerships own property that is subject to a mortgage. Under IRC sec. 514, income from debt-financed property generally is treated as unrelated business income to tax-exempt entities. As a result, Taxpayer X's IRA is consid-

ered to have unrelated business income for federal income tax purposes.

For 1991, the IRA has more than \$1,000 of gross income from an unrelated trade or business. Therefore, the IRA must file federal Form 990-T and Wisconsin Form 4T and pay federal and Wisconsin tax on its unrelated business taxable income. All of the IRA's unrelated business income for 1991 was passed through from partnerships of which it is a member.

Is the IRA subject to the temporary recycling surcharge?

Answer: No. Since all of the IRA's unrelated business income for 1991 was passed through from partnerships, the IRA is not subject to the temporary recycling surcharge on that income, provided the partnerships paid any temporary recycling surcharge due on the income.

Section 77.93(2), Wis. Stats. (1991-92), provides that the temporary recycling surcharge is not imposed on the net business income of individuals for which the surcharge is imposed on a partnership of which an individual is a partner or a tax-option (S) corporation of which an individual is a shareholder. This same treatment applies to trusts, including tax-exempt trusts with unrelated business taxable income, whose business income is passed through from partnerships or tax-option (S) corporations. □



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 private letter rulings are included:

Individual Income Taxes

Capital gains — modification
(1987 and thereafter) — IRC
sec. 1256 contracts
W9251013, September 24,
1992 (p. 30)

Computer software — programs
(canned vs. custom)

Computer software — related
charges
W9253016, October 8, 1992
(p. 33)

Sales and Use Taxes

Computer software — programs
(canned vs. custom)
Computer software — related
charges
W9251014, September 25,
1992 (p. 31)

Construction contractors
(activities) — exempt entity
construction
W9251015, September 28,
1992 (p. 34)



W9251013, September 24,
1992

Type Tax: Individual Income

Issue: Capital gains — modification
(1987 and thereafter) — IRC sec.
1256 contracts

Statutes: Sections 71.05(6)(b)9, Wis.
Stats. (1989-90), and 71.01(6)(g),
Wis. Stats., as created by 1991
Wisconsin Act 269

This letter is in response to your request for a private letter ruling in regard to the Wisconsin tax treatment of Internal Revenue Code sec. 1256 contracts.

Facts

IRC sec. 1256 requires all regulated futures contracts, foreign currency contracts, nonequity options, and dealer equity options to be treated as sold for their fair market value on the last day of the taxable year, and any gain or loss shall be taken into account for the taxable year. Furthermore, IRC sec. 1256 requires that any gain or loss on the sale or deemed sale of such contract shall be treated as short-term capital gain or loss to the extent of 40 percent of such gain or loss and long-term capital gain or loss to the extent of 60 percent of such gain or loss, regardless of the holding period.

Request

You request a ruling for taxable year 1992 and future taxable years to clarify the Wisconsin treatment of regulated futures contracts, foreign currency contracts, nonequity options, and dealer equity options as described in IRC sec. 1256. Specifically, you request the department to confirm that the long-term capital gain portion of IRC sec. 1256 contracts are subject to the Wisconsin capital gain exclusion under sec. 71.05(6)(b)9, Wis. Stats. (1989-90).

Ruling

Wisconsin follows the federal treatment of IRC sec. 1256 contracts prescribed under the Code provisions as amended to December 31, 1991. Amendments to the IRC enacted after December 31, 1991, however, will apply for Wisconsin purposes only if the Wisconsin Legislature specifically adopts them. In addition, any amount

of an IRC sec. 1256 contract which is treated as long-term capital gain for federal tax purposes under the IRC provisions that Wisconsin adopts for the particular taxable year qualifies for the Wisconsin capital gain exclusion under sec. 71.05(6)(b)9, Wis. Stats. (1989-90).

Analysis

IRC sec. 1256 requires regulated futures contracts, foreign currency contracts, nonequity options, and dealer equity options to be marked-to-market at year end.

This mark-to-market rule treats each IRC sec. 1256 contract as if it was sold for fair market value on the last business day of the taxable year. Any gain or loss on the contract is included in income for the taxable year, together with the gain or loss on other contracts which were held during the year but closed out before the last business day. In the year these contracts are settled, the taxpayer must adjust the gain or loss actually realized on these contracts to reflect any gain or loss taken into account with respect to the contracts in a prior year. This rule also treats any capital gain or loss on an IRC sec. 1256 contract as if 40% of the gain or loss is short-term capital gain or loss and 60% is long-term capital gain or loss.

Wisconsin generally follows the IRC. Section 71.01(6)(g), Wis. Stats., as created by 1991 Wisconsin Act 269, provides that, for taxable years beginning on or after January 1, 1992, Wisconsin follows the IRC in effect on December 31, 1991. (Note: There are some exceptions to Wisconsin's conformity to the IRC as of December 31, 1991, but these exceptions have no effect on IRC sec. 1256 contracts.) Therefore, the provisions of IRC sec. 1256 apply for Wisconsin tax purposes in the same manner as for federal tax purposes.

The department expressed this position in a tax release titled "Wisconsin Tax Treatment of Section 1256 Contracts" which was published in the April 1987 *Wisconsin Tax Bulletin*.

The remaining question is whether the 60% of the IRC sec. 1256 contract which is treated as a long-term capital gain (regardless of the holding period) is subject to the Wisconsin capital gain exclusion.

IRC sec. 1256(a)(3)(B) provides that any gain or loss with respect to a section 1256 contract shall be treated as "long-term capital gain or loss, to the extent of 60 percent of such gain or loss" IRC sec. 1222(3) defines long-term capital gain as "gain from the sale or exchange of a capital asset held for more than 1 year"

Section 71.05(6)(b)9, Wis. Stats. (1989-90), provides a subtraction from federal adjusted gross income as follows: "On assets held more than one year . . . , 60% of the capital gain as computed under the internal revenue code"

The IRC deems 60% of any sec. 1256 contract's gain to be long-term capital gain. By definition, "long-term capital gain" is gain from the sale or exchange of a capital asset *held more than 1 year*. Because Wisconsin follows IRC section 1256, such gain qualifies as gain from an asset held more than one year for purposes of the capital gain exclusion provided under sec. 71.05(6)(b)9, Wis. Stats. (1989-90). □

✱ **W9251014**, September 25, 1992

Type Tax: Sales and Use

Issue: Computer software — programs (canned vs. custom); Computer software — related charges

Statutes: Section 77.51(20), Wis. Stats. (1989-90), as amended by 1991 Wisconsin Act 269

This letter responds to your request for a private letter ruling regarding the Wisconsin sales and use tax implications of the sale of computer software and related items.

Facts

ABC Corporation, a company based outside Wisconsin, sells computer hardware and software. ABC Corporation's software package is designed specifically for a particular industry.

The software package consists of separate modules including job status, estimating, accounts payable, accounts receivable, general ledger, and payroll.

A customer may start with a portion of the package (a minimum of 4 modules) and add to the package as business needs change (a present maximum of 15 modules). A customer will typically purchase 4 to 10 modules.

Depending on hardware and the number of modules purchased, the software package sells for \$15,000 to \$100,000.

Prior to a sale, ABC Corporation's sales people spend several sessions (approximately 12 to 20 hours) with a prospective client to determine their precise accounting and job costing needs.

After the sale, an account consultant will work with the client to further determine the client's needs and to tailor the system to meet the client's needs. This consultation lasts one to five days.

Parameters and tables are set which allow for changes in the functionality of the program, without actually modifying the program. For example, a parameter might indicate whether a client is on the cost or accrual basis of accounting. This type of modification is needed for each system sold, as the software will not function properly without it. A system that would only require these changes could be delivered in several weeks.

For the majority of the systems sold, modifications to the actual programs are needed. These changes are in addition to changes made to parameters and tables. For example, a change to the program might be made to provide additional screens or reports. Modifications to the programs can take months to complete.

An installation manager supervises the installation and testing of the system. This normally takes from 2 to 5 days.

ABC Corporation's support staff provides on-site training on the application software. This training normally lasts one day for each module purchased.

Documentation includes a manual with detailed instructions for each module purchased and a manual containing an overview of the system.

Maintenance and support are a required part of the system. The client must maintain a modem to allow ABC Corporation to diagnose and cure problems. An ABC Corporation technician, while at ABC Corporation's home office, can make changes to a customer's program, test it, and have it ready for the customer, all through the use of a modem.

Updates and enhancements typically come out once a year.

ABC Corporation does not provide the client with a copy of the source code (programs), although the client may purchase the code separately if needed.

The principal reason for the client wanting the source code would be for backup protection.

Ruling Request

You ask whether Wisconsin sales or use tax applies to:

1. The sale of ABC Corporation's software and related maintenance, training, and updates, and
2. The sale of ABC Corporation's source code, as a transaction separate from the sale of the software system.

Ruling

The software sold by ABC Corporation is the sale of custom programs and is not subject to Wisconsin sales or use tax. Other charges relating to the sale of custom software are also not taxable, except training materials provided for a specific charge. The separate sale of the source code is not taxable.

Analysis

Effective May 1, 1992, sec. 77.51(20), Wis. Stats. (1989-90), was amended by 1991 Wisconsin Act 269, to clarify that tangible personal property includes computer programs, except custom computer programs.

In a decision of *Wisconsin Department of Revenue v. International Business Machines Corporation*, that

made-to-order computer programs were not subject to Wisconsin sales tax.

Section Tax 11.71(1)(e), Wis. Adm. Code, provides that "The determination of whether a program is a custom program shall be based upon all the facts and circumstances, including the following:

1. The extent to which the vendor or independent consultant engages in significant presale consultation and analysis of the user's requirements and system.
2. Whether the program is loaded into the customer's computer by the vendor and the extent to which the installed program must be tested against the program's specifications.
3. The extent to which the use of the software requires substantial training of the customer's personnel and substantial written documentation.
4. The extent to which the enhancement and maintenance support by the vendor is needed for continued usefulness.
5. There is a rebuttable presumption that any program with a cost of \$10,000 or less is not a custom program.
6. Custom programs do not include basic operational programs.
7. If an existing program is selected for modification, there must be a significant modification of that program by the vendor so that it may be used in the customer's specific hardware and software environment."

ABC Corporation meets the criteria set forth in sec. Tax 11.71(1)(e), Wis. Adm. Code, because:

1. Significant presale consultation (12 to 20 hours) is conducted to determine the needs of a client.
2. ABC Corporation installs and tests the program against the customer's requirements.
3. One to two days of training is required for each module purchased.
4. For most systems, the cost far exceeds \$10,000.
5. All of the software sold is built-to-order as the systems are tailored for each business and computer environment. In addition, for the majority of the systems sold significant modifications are made to the programs.

Section Tax 11.71(2)(c), Wis. Adm. Code, provides that training services are not taxable, although any training materials provided for a specific charge are taxable.

Section Tax 11.71(3)(c), Wis. Adm. Code, provides that technical support, error correction services, and maintenance and enhancement to custom programs are not taxable.

Section Tax 11.67, Wis. Adm. Code, provides that when a transaction involves the transfer of tangible personal property along with the performance of a service, the true objective of the purchaser must be determined. The sale of source code, even though a separate sale from the sale of the software, is incidental to the transfer of nontaxable custom programs.

The amendment of sec. 77.51(20), Wis. Stats. (1989-90), by 1991 Wisconsin Act 269, has no impact on the

taxability of the software sold by ABC Corporation. Accordingly, this ruling is effective to transactions entered into prior to May 1, 1992, and on or after May 1, 1992. □

✱ **W9253016**, October 8, 1992

Type Tax: Sales and Use

Issue: Computer software — programs (canned vs. custom); Computer software — related charges

Statutes: Section 77.51(20), Wis. Stats. (1989-90), as amended by 1991 Wisconsin Act 269

This letter responds to your request for a private letter ruling regarding the Wisconsin sales and use tax implications of the sale of a computer software system and related charges.

Facts

XYZ Corporation, a Wisconsin-based company, develops and sells computer software applications to manufacturers and distributors, and to customers in the food and dairy industry.

XYZ Corporation sold software applications to Company W, which is based in Wisconsin and has several locations outside of Wisconsin.

Prior to the installation of the software, XYZ Corporation employees spent 90 hours on a system study to determine the needs of Company W.

The contract provides that installation, training, and modifications are billed at the normal hourly rate of \$60.

As a part of the contract, specific requirements of the system are spelled out. These requirements are

met by making modifications to the base program. Initially, in excess of 50 modifications were identified.

Modifications include adding fields, changing fields, producing additional reports required by Company W, changing the appearance of certain reports and screens, adding files, and allowing certain operations to function on specific processing units at specific times.

Telephone support is available at \$60 per hour, with a 1/2 hour minimum. Telephone charges, travel time, and expenses are billed as the actual charges are incurred.

The base software sold included financial applications totalling \$39,000 for the Wisconsin location and \$60,500 for out-of-state locations.

From March 1990, through May 1992, XYZ Corporation invoiced Company W for the following: modifications to the base software; training; installation at the Wisconsin location; installation at out-of-state locations; customer support and further system study and meetings; UPS charges to out-of-state locations; travel expenses; and telephone expenses (use of the communications line to remote locations).

All transactions have had sales tax included.

Ruling Request

You ask whether sales tax applies to any or all of the items billed by XYZ Corporation to Company W.

Ruling

The software sold by XYZ Corporation to Company W is the sale of custom programs and is not subject to sales tax. Charges related to the sale of custom software are not

subject to Wisconsin sales or use tax, including billings for UPS charges, travel costs, and telephone expenses.

Analysis

Section Tax 11.71(3)(b), Wis. Adm. Code, provides that the gross receipts from the sale of custom programs are not taxable. Paragraph (e) provides that consulting services, feasibility studies, and other services related to custom programs are not taxable.

Section Tax 11.71(1)(e), Wis. Adm. Code, provides that the "determination of whether a program is a custom program shall be based upon all the facts and circumstances, including the following:

1. The extent to which the vendor or independent consultant engages in significant presale consultation and analysis of the user's requirements and system.
2. Whether the program is loaded into the customer's computer by the vendor and the extent to which the installed program must be tested against the program's specifications.
3. The extent to which the use of the software requires substantial training of the customer's personnel and substantial written documentation.
4. The extent to which the enhancements and maintenance support by the vendor is needed for continued usefulness.
5. There is a rebuttable presumption that any program with a cost of \$10,000 or less is not a custom program.
6. Custom programs do not include basic operational programs.

7. If an existing program is selected for modification, there must be a significant modification of that program by the vendor so that it may be used in the customer's specific hardware and software environment."

The sale by XYZ Corporation to Company W meets the definition of custom software in sec. Tax 11.71(1)(e), Wis. Adm. Code, because:

1. Significant presale consultation (a system study taking 90 hours) was conducted to determine the needs of Company W.
2. XYZ Corporation installed and tested the program against the customer's requirements.
3. In excess of 200 hours of training has been billed to Company W.
4. The base cost of the software and subsequent modifications far exceed \$10,000.
5. Based on the time involved, the number of modifications made, and complexity of modifications, significant modifications are being made to customize the programs to meet Company W's needs.

The fact that some of the charges are being separately invoiced does not affect the status of the software. The terms of the contract provide that additional modifications will be made before the system will be acceptable to Company W and that the modifications will be made by XYZ Corporation. The base software is not taxable as it is only being used as a shell (or starting point) for the customized system.

Section Tax 11.71(2)(c), Wis. Adm. Code, provides that training services

are not taxable, although any training materials provided for a specific charge are taxable. ☐

✴ **W9251015**, September 28, 1992

Type Tax: Sales and Use

Issue: Construction contractors (activities) — exempt entity construction

Statutes: Section 77.54(9a), Wis. Stats. (1989-90)

This letter responds to your request for a private letter ruling regarding the Wisconsin sales and use tax implications of performing real property construction for an exempt entity.

Facts

DEF Company ("Contractor") has entered into a real property construction contract with an entity exempt from Wisconsin sales or use tax under sec. 77.54(9a), Wis. Stats. (1989-90) ("Owner"). The contract in part provides the following:

Under Wisconsin Law, the Contractor is required to pay all sales and/or use taxes on materials and equipment purchased by it for the work of construction described herein. Certain types of exempt organizations, however, may purchase materials and equipment without the payment of Wisconsin sales or use taxes, meaning that sales and use taxes can be saved with respect to the materials and equipment which the exempt entity, rather than the Contractor, purchases directly from suppliers. Because the Owner in this case has represented that it is an organization exempt from the payment of Wisconsin sales or use tax, the materials and equipment pur-

chased directly by the Owner will not be subject to Wisconsin sales and use tax.

Accordingly, the Owner shall purchase directly any equipment and materials for the work of construction where the total cost of an item or any aggregation of items to be ordered from one supplier is two thousand dollars (\$2,000) or more. At the end of this section is set forth a list of items of materials and equipment which shall be purchased directly by the Owner. Except as stated below, Contractor will under no circumstances purchase any equipment or materials set forth on the attached listing.

For purposes of submitting a contract bid, the Contract Sum shall include the cost to the Owner of the work to be performed for the work of construction and shall include all labor and services and the total cost, including applicable taxes, of only the materials and equipment to be purchased by the Contractor for the completion of the work of construction. The Contract Sum shall not include any amount for the materials and equipment to be purchased directly by the Owner and, if the Contract Sum as stated in the bid does for any reason include the cost of materials that are to be purchased by the Owner, the Construction Manager shall revise the Bid so that the Contract Sum does not include any amount for such items.

In addition to preparing its contract bid, Contractor shall separately state the total cost of all materials and equipment that will be purchased directly by Owner. Contractor shall also submit a schedule of all purchases to be made by Owner including the

recommended supplier's name, a general description of the item(s) to be purchased, and the maximum price for each item. Owner will purchase from the suppliers recommended by the Contractor, unless the Owner is able to secure more advantageous prices. Any discounts, savings and rebates belong to Owner. If the Owner is not able to obtain such or comparable materials or equipment within the maximum price, Owner may, at its option, purchase the materials at the higher price (in which case the Contract Sum shall be reduced by the difference between the higher price and the listed maximum price) or require the Contractor to purchase those items (in which case the Contract Sum shall be increased, but only by the stated maximum price of the items in question plus applicable sales or use taxes).

For those items to be purchased directly by the Owner, the Construction Manager will prepare and review the proposed purchase orders, which will be signed by the Owner. The supplier shall invoice the Owner for the items purchased and the Owner shall pay the supplier directly with the Owner's own funds.

The Owner shall receive, store and protect all materials and equipment until provided to Contractor at the job site or such place as designated by Contractor. Until such equipment and materials are delivered to the job site, Owner shall have sole and complete responsibility for such materials and equipment, including without limitation, loss or damage thereto. Upon delivery to the job site or other location designated by the Contractor, Contractor shall store, safeguard

and protect the materials; provided, however, that Contractor shall be liable for any loss or damage to the materials and equipment only if negligent in performing these duties.

Upon delivery of the directly purchased materials and equipment to the job site or such other place designated by the Contractor, Contractor shall also be responsible for inspecting or examining the materials to assure the Owner they are acceptable and in conformance with the contract documents. Any defect, shortfall or other deficiency shall be called to the attention of the Owner immediately upon delivery in order that the Owner may obtain any necessary adjustment or replacement of such materials and equipment. Upon acceptance of such equipment and materials, the Contractor is responsible for the installation and incorporation of such materials into the work of construction in accordance with its agreement with the Owner and the contract documents generally.

The Owner shall at all times have and possess all incidents of ownership with respect to the materials and equipment purchased by it. Accordingly, Contractor shall not be responsible for any defect, shortfall, or other deficiency with respect to materials and equipment purchased by the Owner, regardless of whether such defect is discovered or occurs before, during or after installation, unless Contractor is negligent in performing its duties under the contract. The Owner is solely responsible for obtaining and/or perfecting any warranties, express or implied, with regard to those materials and equipment purchased directly by it. Owner shall insure its interest in such

equipment and materials or arrange with Contractor to be added as an additional insured to any insurance policy covering equipment and materials located at the job site or such other location where the materials may be stored.

As part of the consideration received under the Contract, Contractor agrees that it will install any replacement materials provided by vendors, suppliers or manufacturers within a period of two years after the contract is completed. Such responsibility relates to installation only and, by agreeing to perform this service, Contractor in no way assumes any responsibility for defects or other deficiencies in the materials, unless such defect or deficiency is due to negligence by the Contractor in performing its duties under the contract.

Owner shall indemnify and hold the Contractor harmless from and against any and all claims asserted against the Contractor relating to the liability for sales and/or use tax (including penalties and interest and, in the event of litigation, all reasonable expenses, including attorney's fees and accountant's fees incurred by Contractor in connection therewith) on any materials or equipment purchased by Owner, provided that (1) Contractor promptly tenders to Owner the defense, negotiation, or other handling of such claim, (2) Owner shall have the right, at its own expense, to assume defense of the claim, and (3) Contractor shall cooperate fully with Owner in providing any and all information which Owner reasonably requests in connection with defense of the claim.

Request

You ask the following:

1. Is the sale of materials by suppliers to the exempt Owner subject to Wisconsin sales or use tax?
2. Is Wisconsin sales or use tax due as a result of the Contractor's use of the materials purchased by the exempt Owner?

Ruling

Based on representations provided in your request and restated in the facts above:

1. The sale of the materials by suppliers to the exempt Owner is not subject to Wisconsin sales or use tax. However, if the supplier is the person who will install the materials purchased directly by the Owner, the supplier is the consumer of the materials and is subject to Wisconsin sales or use tax on its cost of the materials.

(Note: Although not stated in the contract, it is assumed that the purchase orders which are prepared by the Contractor and signed by the Owner are purchase orders of the Owner).

2. There is no sales or use tax due as a result of the Contractor's use of materials purchased by the exempt Owner.

Analysis

Section Tax 11.04(5), Wis. Adm. Code, provides that a supplier's sales of building materials made directly to an exempt entity, as defined in sec. 77.54(9a), Wis. Stats. (1989-90), are not taxable, even though such tangi-

ble personal property is used by the contractor in the erection of a building or structure, or in the alteration, repair, or improvement of real property for the exempt entity. This exemption applies provided the exempt entity gives its own purchase order to the supplier for the tangible personal property and pays for the tangible personal property with its own funds.

Section Tax 11.04(4), Wis. Adm. Code, provides that a supplier who is also the contractor who uses the building materials in the construction of buildings or structures, or the alteration, repair, or improvement of real property for an exempt entity, is the consumer of such building materials, not the seller of tangible personal property to the exempt entity. The sale of building materials to the consumer is subject to tax.

Since the Owner is purchasing the materials and equipment, listed as part of the contract, with its own purchase orders and paying for the materials and equipment with its own funds, the sales of the building materials by suppliers to the Owner are exempt from Wisconsin sales or use tax. However, if the Owner purchases any of the materials and equipment from a supplier who will install those materials and equipment, the supplier is the consumer of the equipment and must pay sales or use tax on its purchase of the materials and equipment. The supplier may pass the sales or use tax on to the exempt entity as a cost of doing business.

In the tax release titled "Purchases of Building Materials by Exempt Entities for Use By Contractor in Real Property Construction," which was published in *Wisconsin Tax Bulletin* 74 (October 1991), it is provided that

if the following conditions are met, there is no taxable sale of materials and equipment transferred by the exempt entity to the contractor:

1. The contract between the exempt entity and contractor states that the contractor is to provide only those materials and equipment not purchased directly by the exempt entity, and
2. There is no reduction in the contract price for any materials and equipment purchased directly from suppliers by the exempt entity.

Since the contract does not provide that the Contractor is to furnish those materials and equipment that will be purchased directly by the Owner from suppliers and the contract price will not include the price of materials and equipment the Owner will purchase directly from suppliers, the transfer of materials and equipment from the Owner to the Contractor is not subject to Wisconsin sales or use tax.

If the Owner is unable to obtain materials and equipment within the maximum price and purchases such materials and equipment at a higher

price resulting in the contract sum being reduced by the difference between the higher price and the maximum price, the sales and use tax treatment of the transaction shall not be affected. Such reduction in the contract price is considered to be a penalty imposed on the Contractor because of the Owner's failure to obtain materials and equipment at the maximum price, rather than consideration for the transfer of materials and equipment from the Owner to the Contractor. □