Number 88 July 1994

# Wisconsin TAX BULLETIN

FOCUS ON . . .

**Your Ideas**

See articles on page 3.

## Mailing of Monthly Sales/Use Tax Returns Changed

A change in the mailout procedure for monthly sales and use tax return filers will become effective July 1994. The change results from suggestions to save forms and postage costs, based on a survey of 1,000 monthly filers.

Rather than mailing sales and use tax returns each month, the Department of Revenue will mail all monthly filers three returns during the first month of each calendar quarter. EXAMPLE: Monthly filers will be sent July, August, and September 1994 returns by the end of July. This mailing will also contain instructions, three worksheet copies for taxpayers' files, and three return mailing address labels. □

## New Sales and Use Tax Laws Explained

The Wisconsin Legislature enacted many changes to Wisconsin tax laws in 1994, as described in *Wisconsin Tax Bulletin* 87, dated May 1994. The June *Sales and Use Tax Report* gives further explanations of the major changes to the sales and use tax laws. See pages 31 to 34 of this Bulletin for a copy of the Report, which was sent in June to all active sales and use tax registrants. □

## Focus on Publications: Landscaping

During this summer "spruce-up" time, landscapers and others are busy planting trees and shrubs, seeding and sodding lawns, and installing decorative stones, walks, and retaining walls.

Are any of these services subject to Wisconsin sales and use tax? Answers can be found in the Department of Revenue's Publication 210, "Sales and Use Tax Treatment of Landscaping." A copy of Publication 210, which has been recently updated, appears on pages 35 and 36 of this Bulletin. □

## Do You Owe Use Tax on Mail-Order Purchases?

If you buy items from mail-order companies who do not charge Wisconsin sales or use tax, you may owe Wisconsin use tax.

Office supplies, computer equipment, paper, and furniture are common examples of mail-order purchases which result in the buyer owing use tax.

If you hold a seller's permit, you should report use tax owed on your sales and use tax return, Form ST-12. If you are not required to hold a seller's permit and regularly make purchases subject to use tax, you should apply for a consumer use tax registration certificate.

If you make infrequent purchases subject to use tax, the use tax may be reported on a consumer use tax return, Form UT-5. Individuals may also report use tax on their individual income tax return. □

## Extension of Time for Increasing Section 179 Deduction

The Budget Adjustment Bill (1993 Wisconsin Act 437), signed April 25, 1994, and published May 9, 1994, includes provisions which adopt the change in the federal Internal Revenue Code (IRC) made by Public Law 103-66 which increased from $10,000 to $17,500 the maximum cost of depreciable property that can be expensed under sec. 179, IRC. This conformity to the new sec. 179 limits for Wisconsin purposes is effective for taxable years beginning in 1993 and thereafter.

Federal law and federal Reg. 1.179-5 require that the sec. 179 election must be made on the taxpayer's first income tax return for the taxable year the property was placed in service or on an amended return filed no later than the due date (including exten-

## In This Issue



sions) of the return for the tax year the property was placed in service.

Because the Budget Adjustment Bill did not become law until after the due date of many 1993 income and franchise tax returns, the Department of Revenue will accept an amended return filed within four years after the original (unextended) due date of a 1993 return to increase the amount of sec. 179 expense deduction up to $17,500 (maximum amount allowable under federal law). A taxpayer other than an insurance company is not required to claim the same sec. 179 amount on the 1993 Wisconsin return as on the 1993 federal return. A taxpayer may claim a sec. 179 deduction for an amount up to $17,500 on the 1993 Wisconsin return (regardless of the amount claimed on the 1993 federal return), provided the amount qualifies for deduction under sec. 179, IRC.

EXAMPLE: An individual whose 1993 return was due April 15, 1994, claimed $15,000 on his or her federal return as a sec. 179 deduction. The $15,000 amount is the total amount that qualified for deduction under sec. 179, IRC. For Wisconsin purposes the individual claimed $10,000 as a sec. 179 deduction on the original 1993 Wisconsin return which was filed by April 15, 1994. This individual will have until April 15, 1998 (four years after the original due date of the Wisconsin return) to file an amended Wisconsin return to increase his or her sec. 179 expense deduction up to $15,000 for Wisconsin.

This extension applies only to 1993 returns.

For more information regarding sec. 179 expense deductions for corporations, see the tax release titled "Wisconsin Treatment of Section 179 Expense Deduction," beginning on page 22 of this Bulletin. □


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## Buyers May File Sales/Use Tax Claims for Refund Beginning September 1, 1994

A new law, 1993 Wisconsin Act 437, will allow buyers to file claims for refund of sales or use taxes paid in error to sellers. Such claims may be filed on or after September 1, 1994. However, the claims may include sales or use taxes paid to sellers prior to September 1, 1994.

Questions have been asked about buyers who are currently being field audited and who want to file a claim for refund under this new law. If a buyer being field audited paid sales or use tax in error to sellers during the period being field audited, the buyer may file claims for refund on or after September 1, 1994. Also, a claim for refund relating to the period being field audited must be filed by the buyer prior to the department's issuance of a notice of determination regarding the field audit.

If the time for issuing a notice of determination is extended by agreement between the taxpayer (buyer) and the Department of Revenue, the buyer may, during the extended time period, but prior to the issuance of the notice of determination, file a claim for refund of sales and use taxes erroneously paid to a seller during the period being audited.

EXAMPLE: A buyer is field audited for the years 1989-1992. The 1989 year is open to adjustment until March 15, 1994 (4 years from the unextended due date of the 1989 return). The buyer and the department agree in writing to extend to November 1, 1994, the time period in which the department may issue a field audit notice of determination. The buyer discovers that it paid sales or use tax in error to a seller in 1989. A claim for refund by the buyer must be filed (1) by November 1, 1994 (the extended date for issuing a notice of determination) or (2) prior to the issuance of the notice of determination, whichever is earlier. (Note: Such claim may not be filed with the department prior to September 1, 1994.)

The department is currently drafting a new publication titled "Filing Claims for Refund of Sales and Use Tax." This publication will explain who may file claims for refund of sales or use tax, which forms to use, time limitations for filing, interest and penalties, etc. A copy of the publication will be included in the October 1994 *Wisconsin Tax Bulletin*. □

## Wanted: Your Comments About the *Wisconsin Tax Bulletin*

The *Wisconsin Tax Bulletin* (WTB) is published to provide tax information to **YOU**, the readers. To make the WTB more useful to you, the department is seeking suggestions for items that may be of interest to you, and ways to make the WTB more valuable to you.

How could the department improve on the information it publishes? What areas would you like to see covered or expanded? Do you have any particular likes or dislikes about the WTB? Do you have any other ideas, comments, or suggestions you'd like to share?

Please take a few moments to put your comments or ideas in writing, and be a part of improving ***your*** WTB. Send your comments or ideas to Wisconsin Department of Revenue, Administration Technical Services, P.O. Box 8933, Madison, WI 53708-8933. We'd like to hear from you! □

## Do You Have Ideas or Suggestions for 1994 Tax Forms?

Do you have comments, ideas, or suggestions for improving Wisconsin's tax forms or instructions? Can you think of ways the forms or instructions could be made easier to understand? If so, the department would like to hear from you.

Please take a few moments to put your ideas in writing, and send them to Wisconsin Department of Revenue, Administration Technical Services, P.O. Box 8933, Madison, WI 53708-8933. Your suggestions could help make "tax time" easier for taxpayers and practitioners. □

## Use Tax Self-Audit of Attorneys

Over 11,000 letters and worksheets are being sent to attorneys and attorney firms during April through August, 1994. This mailing is part of a use tax self-audit project being conducted by the Department of Revenue's Audit Bureau.

In an earlier phase of the self-audit project, the department contacted 8,000 CPA firms, self-employed CPAs, tax preparers, tax preparation firms, and enrolled agents (see *Wisconsin Tax Bulletin* 82 (July 1993), page 1). Over $600,000 of use tax, interest, and late filing fees were collected as a result of this project, and 127 taxpayers obtained seller's permits or became registered for use taxes.

The use tax self-audit project will include other professionals in the future. The registration of tax practitioners, attorneys, and others should result in greater use tax compliance in the future. □

## 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 |

□

## Sales and Use Tax Treatment of Bottled Water Changed

The department recently nonacquiesced in regard to the Wisconsin Tax Appeals Commission decision of *Artesian Water Company, Inc. vs. Wisconsin Department of Revenue*, which held that the sale of bottled artesian spring water was exempt from Wisconsin sales or use tax under sec. 77.54(20)(intro.), Wis. Stats. (1991-92). A summary of this decision appears on page 17 of this Bulletin.

The sales and use tax treatment of bottled water as a result of this decision is provided in the tax release titled "Bottled Water," which appears on page 25 of this Bulletin. □


## Automatic 4-Month Extension Expires August 15

If your 1993 Wisconsin and federal individual income tax returns were due April 15, 1994, but you filed an application for an automatic 4-month extension for filing your federal return with the Internal Revenue Service (IRS), both your federal and Wisconsin returns are due August 15, 1994. When you file your Wisconsin return, be sure to attach to it a copy of the federal extension application, Form 4868.

Any filing extension available under federal law may be used for Wisconsin purposes, even if you are not using that extension of time to file your federal return. If you did not file a federal extension application but needed a 4-month extension for Wisconsin only, your 1993 Wisconsin return, ordinarily due April 15, 1994, must be filed by August 15, 1994. In this situation, you should attach a statement to the 1993 Wisconsin return you file, indicating that you are filing under the federal automatic 4-month extension provision, or attach a copy of federal Form 4868 with only the name, address, and signature areas completed.

(Note: You are not required to pay your 1993 taxes by April 15, 1994, as a condition for receiving an extension of time to file your tax return. However, even though you may have an extension of time to file your return, you will owe interest of 1% per month on any tax not paid by April 15, 1994.) □

## Federal Retirement Benefit Tax Claim Agreements

On April 5, 1994, the Attorney General's office, the Department of Revenue, and the law firm of O'Neil, Cannon & Hollman, S.C. representing approximately 14,000 individuals participating in the class action in *Wisconsin Department of Revenue v. Hogan, et al.*, reached an agreement in regard to the taxability of federal retirement benefits for those retirees who filed timely claims for refund for the 1984 through 1988 tax years.

The department reached a similar agreement on February 2, 1994, with approximately 3,200 refund claimants who were members of the Wisconsin Military Retirees' Alliance represented by Cook and Franke, S.C. The department also offered the same settlement to about 600 persons who were not part of the Military Alliance and who chose to opt-out of the class group.

The similarities of the above agreements are:

1. The only years for which payment can be made are 1984 through 1988.
2. The department will determine the timeliness, eligibility, and dollar amount of each refund claim.
3. Timely, verified refund claims will be paid in six approximately equal installments.
4. Refunds of interest will be made before tax. Interest at the statutory rate of 9% per year will be paid on the unrefunded tax.
5. A timely refund claim for one year will constitute a timely refund claim for all subsequent tax years through 1988 unless a timely, written appeal was not made of any adverse determination by the department with respect to such refund claim.

Each eligible claimant has received a letter from the department explaining the agreement. The letter also requested that each individual complete a questionnaire and release or closing agreement, and attest that he or she was a member of or retired from the federal retirement system as of December 31, 1963. The questionnaire and release or closing agreement, and attestation must have been signed and returned to the department by the specified date in order for the claimant to receive the first installment payment by the date agreed to in the settlement.

For deceased claimants, the questionnaire and release or closing agreement and attestation may be completed by the personal representative of the estate or a beneficiary. Refunds for deceased claimants will be issued directly to the beneficiaries unless the personal representative requests in writing that the refund be paid to the estate. Each beneficiary must sign a release. Any inheritance or estate tax due as a result of including the tax refund, plus interest accrued to date of death, as an additional taxable asset of the deceased claimant's estate will be deducted from the refund.

Following is a summary and comparison of the three groups:

| | Class Action | Military Retirees' Alliance | Opt-Outs |
|---|---|---|---|
| Notification letter, questionnaire, and release sent: | 4-15-94 | 2-11-94 | 2-11-94 |
| Request to be returned to department by: | 5-15-94 | 3-15-94 | 2-28-94 |
| Closing agreement sent: | — | — | After 3-1-94 |
| Closing agreement returned to department by: | — | — | 3-29-94 |
| 1st installment payment: | 6-30-94 | 5-15-94 | 5-15-94 |
| 2nd installment payment: | 11-15-94 | 11-15-94 | 11-15-94 |
| 3rd installment payment: | 5-15-95 | 5-15-95 | 5-15-95 |
| 4th installment payment: | 11-15-95 | 11-15-95 | 11-15-95 |
| 5th installment payment: | 5-15-96 | 5-15-96 | 5-15-96 |
| 6th installment payment: | 11-15-96 | 11-15-96 | 11-15-96 |

NOTE: The above dates apply to the majority of the claimants. However, the first installment payment for some individuals could be delayed for a number of reasons; for example, a second letter requesting additional information is required, a current address is unavailable, or there is a question as to whether the claimant is included in a certain group.

For members of the class action represented by the law firm of O'Neil, Cannon & Hollman, S.C., litigation will continue in regard to the following issues:

1. Certification of the class.
2. Untimely claims or appeals.
3. Payment of attorney fees.*
4. Interrupted federal service on or after December 31, 1963.

* The department will deduct 15% of the face amount of each refund check to be placed in a separate escrow account for payment of attorney fees, subject to further court order.

If you have any questions you may call the department's Central Audit unit at (608) 266-2441. You may also call Attorney Eugene Duffy at (414) 963-8568 if you are included in the class action suit. Members of the Wisconsin Military Retirees' Alliance group may call Mr. Joseph D'Amico at (414) 258-4341. □

## Oconto County Adopts County Tax

Effective July 1, 1994, the county sales and use tax was adopted by Oconto County. This brings to 46 the number of counties that have adopted the ½% county tax. Adams County adopted the tax effective January 1, 1994, and Dodge County adopted the tax effective April 1, 1994.

The March 1994 *Sales and Use Tax Report*, a copy of which appears in *Wisconsin Tax Bulletin* 86 (April 1994), pages 33 and 34, includes a listing of the counties that have adopted the county tax. □

## *Wisconsin Tax Bulletin* Annual Index Included

Once each year the *Wisconsin Tax Bulletin* includes an index of articles, tax releases, court cases, private letter rulings, and other materials that have appeared in past Bulletins. The index for issues 1 (October 1976) to 85 (January 1994) can be found on pages 37 to 61 of this Bulletin. □

## Boiler Maker Gets Burned

A 38-year-old Prairie du Chien man, Roy O. Dobbs, has been sentenced to 18 months in jail for three counts of failure to file income tax returns for 1988, 1989, and 1990. Dobbs had been placed on probation in May 1993 and ordered to file the tax returns. He was jailed in December for violating the terms of his probation by failing to file the returns.

Dobbs, formerly of Kenosha, was found to have earned more than $100,000 as a boiler maker in Milwaukee during 1988 to 1990, and he also received $6,216 of unemployment compensation. Court records show that Dobbs owed the state approximately $5,200 for the three years, and that he has not filed a state or federal income tax return since 1981.

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A self-employed West Bend trucker, Roger R. Dahm, 49, was charged in Dane County Circuit Court in April 1994, with four counts of felony income tax evasion. Dahm was charged with filing fraudulent Wisconsin income tax returns for 1987, 1988, 1989, and 1990. The criminal complaint alleges that he intentionally understated his income by more than $100,000 over those four years.

According to the complaint, during 1987 to 1990 Dahm operated a corporation that was engaged in grain

hauling. However, during an audit of Dahm's tax returns, it was discovered that he also operated a separate business making sales of grain. Dahm allegedly deposited money from these sales into separate bank accounts, hid this operation from his accountant, and failed to report any income from it. Dahm had apparently been operating this other business, without reporting income from it, for up to fourteen years, and he used profits from the operation to make investments, purchase a pole building, and pay other personal living expenses.

Dahm faces a maximum penalty of up to twenty years in prison and $40,000 in fines, if convicted on all counts.

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Attorney William A. Wentzel, 46, Nashotah, Wisconsin, was charged in April 1994 by the Waukesha County District Attorney's office, with two counts of failure to file Wisconsin income tax returns. The complaint alleges that Wentzel failed to file income tax returns for 10 consecutive years, including 1990 and 1991. Wentzel had gross income of $44,723 in 1990 and $13,550 in 1991. If convicted on both counts, Wentzel faces a maximum penalty of eighteen months in jail and up to $20,000 in fines. In addition to the criminal penalties, Wisconsin law provides for substantial civil penalties on the civil tax liability. Assessment and collection of the taxes, penalties, and interest due follows convictions for criminal violations.

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Also in April 1994, an arrest warrant was issued for a Madison stockbroker, William C. Seitz, 47, because he failed to appear in Dane County Circuit Court to answer charges of failure to file income tax returns. He was charged by the Dane County District Attorney's office with three counts of failure to file Wisconsin income tax returns.

The complaint alleges that Seitz failed to file Wisconsin income tax returns for the years 1990, 1991, and 1992, when he had a combined gross income in those years of $104,423. If convicted on all three counts, Seitz faces a maximum penalty of 27 months in jail and up to $30,000 in fines. □

# Question and Answer

**Q** We file our Wisconsin corporation franchise tax returns on a calendar year basis. We have received an extension until September 15, 1994, to file our 1993 federal corporation income tax return. We have heard that the Wisconsin law was changed to allow corporations that have received a federal extension an additional 30 days to file their Wisconsin returns. What do we have to do to request this additional 30-day extension?

**A** Since you have received a federal extension, you do not have to request a Wisconsin extension. You automatically have 30 days after the federal extended due date to file your Wisconsin return. Your 1993 Wisconsin return is due October 15, 1994. However, you must attach a copy of your federal extension to the Wisconsin return that you file. □

## 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, nonprofit 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 vehicle fuel, alternate 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 63 of this Bulletin. The order blank may also be used for subscribing to the *Wisconsin Tax Bulletin* and for ordering the Wisconsin Administrative Code. □

## Tax Publications Available

The Department of Revenue publishes over 35 publications that are available, free of charge, to taxpayers or practitioners. To order any of the publications, write or call Wisconsin Department of Revenue, Shipping and Mailing Section, P.O. Box 8903, Madison, WI 53708-8903 (telephone (608) 266-1961).

| Number | Title of Publication |
|---|---|
| 102 | Wisconsin Tax Treatment of Tax-Option (S) Corporations and Their Shareholders |
| 103 | Reporting Capital Gains and Losses for Wisconsin by Individuals, Estates, Trusts |
| 104 | Wisconsin Taxation of Military Personnel |
| 109 | Tax Information for Married Persons Filing Separate Returns and Persons Divorced |
| 111 | How to Get a Private Letter Ruling From the Wisconsin Department of Revenue |
| 112 | Wisconsin's Individual Estimated Tax and Corporation Estimated Tax Programs |
| 113 | Federal and Wisconsin Income Tax Reporting Under the Marital Property Act |
| 114 | Wisconsin Taxpayer Bill of Rights |
| 117 | Guide to Wisconsin Information Returns |
| 200 | Sales and Use Tax Information for Electrical Contractors |
| 201 | Wisconsin State and County Sales and Use Tax Information |
| 202 | Sales and Use Tax Information: Motor Vehicle Sales, Leases and Repairs |
| 203 | Sales and Use Tax Information for Manufacturers |
| 205 | Do You Owe Wisconsin Use Tax? (Individuals) |
| 206 | Sales Tax Exemption for Nonprofit Organizations |
| 207 | Sales and Use Tax Information for Contractors |
| 210 | Sales and Use Tax Treatment of Landscaping |
| 211 | Sales and Use Tax Information for Cemetery Monument Dealers |
| 212 | Businesses: Don't Forget About Use Tax |
| 213 | Travelers: Don't Forget About Use Tax |
| 214 | Do You Owe Wisconsin Use Tax? (Businesses) |
| 400 | Wisconsin's Temporary Recycling Surcharge |
| 500 | Tax Guide for Wisconsin Political Organizations and Candidates |
| 501 | Field Audit of Wisconsin Tax Returns |
| 502 | Directory of Free Publications |
| 503 | Wisconsin Farmland Preservation Credit |
| 504 | Directory for Wisconsin Department of Revenue |
| 505 | A Taxpayer's Appeal Rights of an Office Audit Adjustment |
| 506 | Taxpayers' Appeal Rights of Field Audit Adjustments |
| 507 | How to Appeal to the Tax Appeals Commission |
| 508 | Wisconsin Tax Requirements Relating to Nonresident Entertainers |
| 509 | Filing Wage Statements and Information Returns on Magnetic Media |
| 600 | Wisconsin Taxation of Lottery Winnings |
| 601 | Wisconsin Taxation of Pari-Mutuel Wager Winnings |
| 700 | Speakers Bureau presenting ... |
| W-166 | Wisconsin Employer's Withholding Tax Guide □ |

## Administrative Rules in Process

Listed below are proposed new administrative rules and changes to existing rules that are currently in the rule adoption process. The rules are shown at their stage in the process as of July 1, 1994, or at the stage in which action occurred during the

period from April 2, 1994, to July 1, 1994.

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 Sent to Revisor for Publication of Hearing Notice**

ch. 4 (title) MOTOR VEHICLE AND GENERAL AVIATION FUEL TAXATION-A
4.01 Portable motor equipment-A
4.02 Resellers' personal claims for refund-A
4.03 Public highways closed to public travel-A
4.04 No printing on back of original invoice-R
4.05 Taxicabs-A
4.10 Motor vehicle fuel tax liability-NR
4.11 Tax exemption for dyed diesel fuel-NR
4.12 Uncollected motor vehicle fuel taxes and repossessions-NR
4.50 Assignment, use and reporting of document number-A
4.51 Measuring withdrawals-A
4.52 Separate schedules-A
4.53 Certificate of authorization-A
4.54 Security requirements-A
4.55 Ownership and name changes-A
4.65 Motor vehicle fuel tax refunds to vendors and tax deductions for suppliers-NR
4.75 Payment of motor vehicle fuel tax-NR
11.04 Constructing buildings for exempt entities-A

**Rules Adopted and in Effect (including date of adoption)**

11.05 Governmental units-A (5/1/94)
11.19 Printed material exemptions-A (5/1/94)
11.34 Occasional sales exemption for sale of a business or business assets-A (5/1/94)
11.56 Printing industry-A (5/1/94)
11.61 Veterinarians and their suppliers-A (5/1/94)
11.68 Construction contractors-A (5/1/94) □

## Recently Adopted Rules Summarized

Listed below is a summary of recent revisions to administrative rules. In addition to the summary, substantive changes and new text are reproduced (examples and notes appearing in the rules are not reproduced here). In the amendments, material lined through (~~lined through~~) represents deleted text, and underscored (underscored) material represents new text.

This issue includes information about secs. Tax 11.05, 11.19, 11.34, 11.56, 11.61, and 11.68, all amended effective May 1, 1994, to reflect changes in the sales and use tax statutes made by 1993 Wis. Act 16.

**Tax 11.05 Governmental units.** Tax 11.05(title) is amended, to add a statutory reference; (2)(f) is amended, to add a cross reference for exempt copying charges; (2)(g), (3)(l), and (4)(c)(intro.), 1, and 2 are amended, to reflect proper language and style; and (3)(u) is created, to address the exemption for sales of animal identification tags and standard samples by the Department of Agriculture. The text of Tax 11.05(2)(f) and (3)(u) is as follows:

11.05(2)(f) Sales of maps, plat books, photocopies or other printed material, except as provided in sub. (3)(p).

(3)(u) Animal identification tags and standard samples representing product or commodity grades only when sold by the Wisconsin department of agriculture, trade and consumer protection.

**Tax 11.19 Printed material exemptions.** Tax 11.19(title) is amended, to add a statutory reference; (2)(e) is amended, to clarify that sec. 77.51(13h), Wis. Stats. (1991-92), is a definition statute, not an exemption statute; (2)(f) is created, (5) is renumbered (6), and new (5) is created, to reflect statutory changes redefining storage and use with respect to raw materials used in printed materials; and (4)(b) is amended, to clarify that it applies to "printed advertising" materials. The text of Tax 11.19(2)(e), (2)(f), and new (5) is as follows:

11.19(2)(e) Section 77.51(13h), Stats., provides ~~an exemption for sales of printed material in Wisconsin by~~ that a foreign corporation that is a publisher of printed materials ~~whose~~ is not engaged in business in Wisconsin and is not required to register and collect Wisconsin sales or use tax if its only activities in Wisconsin are:

(2)(f) Section 77.51(18) and (22), Stats., provides that storage and use for purposes of imposing Wisconsin use tax does not include the keeping, retaining or exercising any right or power over raw materials for processing, fabricating or manufacturing into, attachment to or incorporation into printed materials to be transported outside Wisconsin and thereafter used solely outside Wisconsin.

(5) RAW MATERIALS INCORPORATED INTO PRINTED MATERIALS. Wisconsin use tax is not imposed on raw materials that would otherwise be subject to use tax under s. 77.53(1), Stats., purchased by a publisher or printer of printed materials if both of the following conditions are met:

(a) The raw materials are processed, fabricated or manufactured into, attached to or incorporated into printed materials.

(b) The resulting printed materials will be shipped outside Wisconsin for use solely outside Wisconsin.

**Tax 11.34 Occasional sales exemption for sale of a business or business assets.** Tax 11.34(2)(b)2 and 3 and (5)(c) are amended and (3)(b)3 is repealed, to reflect the removal of the 10-day requirement for the surrender of a seller's permit. The text of Tax 11.34(2)(b)2 and 3 and (5)(c) is as follows:

11.34(2)(b)2. A single transaction or series of transactions ~~at the time of~~ prior to termination of a business.

3. Piecemeal sales, whether part of a continuing business or ~~upon~~ prior to termination.

(5)(c) The fact that a business ceases operating and no longer conducts its day-to-day sales of tangible personal property or taxable services ~~shall~~ may not result in the automatic cancellation of a seller's permit. ~~If the permittee does not surrender the permit as provided in sub. (3)(b), the person shall not qualify for the occasional sale exemption until the permit is surrendered to the department for cancellation.~~

**Tax 11.56 Printing industry.** Tax 11.56 (title) is amended, to add a statutory reference; (3)(a), (3)(c), (5), and (6)(a)1 are amended, to reflect proper language and format; (6)(b)(intro.), 1, and 2 and (7)(b) are amended and (6)(b)3 is repealed, to clarify the department's position that a printer who sells printed materials to a customer who does not resell them meets the "destined for sale" requirement in sec. 77.54(2), Wis. Stats. (1991-92); and (6)(c) is created, to reflect statutory changes redefining storage and use with respect to raw materials used in printed materials. The text of Tax 11.56(6)(b)(intro.), 1, and 2, (6)(c), and (7)(b) is as follows:

11.56(6)(b)(intro.) The ~~exemptions~~ exemption under s. 77.54(2), Stats., described in par. (a)1 and 2, ~~apply~~ applies to property purchased by a person who does not use the property other than to provide it to a manufacturer described in par. (a) for use by the manufacturer in manufacturing tangible personal property to be sold. The exemption under s. 77.54(2), Stats., does not apply if the manufactured tangible personal property is not to be sold by the manufacturer to its customer or by the customer. Examples of nontaxable purchases include:

1. A paper manufacturer's purchases of negatives which it transfers to a printer, who uses the negatives to produce printing ~~on the manufacturer's products which are to be sold~~ which the printer sells to the paper manufacturer.

2. An advertising agency's purchases of color separations which are furnished to a commercial printer who uses the color separations to produce advertising material the ~~agency sells to a retailer~~ printer sells to the advertising agency.

(6)(c) Wisconsin use tax is not imposed on raw materials that would otherwise be subject to use tax under s. 77.53(1), Stats., purchased by a publisher or printer of printed materials if both of the following conditions are met:

1. The raw materials are processed, fabricated or manufactured into, attached to or incorporated into printed materials.

2. The resulting printed materials will be shipped outside Wisconsin for use solely outside Wisconsin.

(7)(b) The tax applies to purchases of artwork, single color or multicolor separations, negatives, flats and similar items if ~~such~~ those purchases are used in the manufacture of tangible personal property not to be sold, other than items exempt under par. (a). A printer who does not supply paper used in printing tangible personal property is not selling tangible personal property but rather, is selling a service.

**Tax 11.61 Veterinarians and their suppliers.** Tax 11.61(title) is amended, to add a statutory reference; (1)(title) is amended to read "SALES BY VETERINARIANS" and (2)(title) is created to read "PURCHASES BY VETERINARIANS," to reflect proper format; (2)(a) is amended and (2)(b) is renumbered (2)(c) and amended, to reflect proper language, style, and format; (2)(b)1 is created, to improve format — it was previously part of (2)(a); and (2)(b)2 is created, to reflect the creation of sec. 77.54(42), Wis. Stats. The text of Tax 11.61(2)(a) and (2)(b)1 and 2 is as follows:

11.61(2)(a) Sales to veterinarians of medicines for pets and sales of other tangible personal property to be used or furnished by them in the performance of their professional services to animals shall be subject to the sales or use tax, except as provided in par. (b)1. ~~A veterinarian's purchases of medicines used on farm livestock, not including workstock, are exempt from tax.~~

(2)(b)1. Veterinarians' purchases of medicines used on farm livestock, not including workstock, are exempt from tax.

2. Veterinarians' purchases of animal identification tags from the Wisconsin department of agriculture, trade and consumer protection are exempt from tax. Purchases of animal identification tags from other suppliers which veterinarians provide to customers in performing professional services to animals are subject to tax.

**Tax 11.68 Construction contractors.** Tax 11.68(title) is amended, to add a statutory reference; and (3)(a) is amended, to reflect the repeal and recreation of sec. 77.53(1), Wis. Stats. The text of Tax 11.68(3)(a) is as follows:

11.68(3)(a) Under s. 77.51(2), Stats., contractors who perform real property construction activities are the consumers of building materials which they use in altering, repairing or improving real property. Therefore, suppliers' sales of building materials to contractors who incorporate the materials into real property in performing construction activities are subject to the tax. This includes raw materials purchased outside Wisconsin that are used by a contractor in manufacturing tangible personal property outside Wisconsin, or that are fabricated or altered outside Wisconsin by a contractor so as to become different or distinct items of tangible personal property from the constituent raw materials, and are subsequently stored, used or consumed in Wisconsin by that contractor. □

# 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

**Farm loss limitation — 1986 and thereafter; Net operating loss — Wisconsin — carryforward.** *Stuart C. and Faye L. Pedersen vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, February 23, 1994). The issues in this case are:

A. Whether the 1986 wages earned by the taxpayers as salaries paid by Pedersen Farms of Warrens, Inc. ("Pedersen Farms") constituted "nonfarm Wisconsin adjusted gross income" for calculating a farm loss limitation under sec. 71.05(1)(a)26, Wis. Stats. (1985-86).

B. Whether the department erred in its application of the taxpayers' net operating loss carryforward in the calculation of 1986 taxable income according to secs. 71.02(2)(j) and 71.05(1)(d), Wis. Stats. (1985-86).

The taxpayers are husband and wife and throughout 1986 jointly owned 89% of the issued and outstanding stock of Pedersen Farms. They were also officers and employes of Pedersen Farms, a Wisconsin "C" corporation whose business in 1986 consisted primarily of farming, from cultivation through harvesting, of a for-profit cranberry marsh. The taxpayers were residents of Wisconsin in 1986 and performed services for Pedersen Farms, for which they earned wages. The services consisted primarily of farming activities but included an incidental amount of administrative tasks.

Taxpayer Stuart Pedersen was a partner in three separate partnerships engaged in the business of owning and operating cranberry marshes, and the taxpayers' allocable share of losses from these partnerships in 1986 was, in the aggregate, $203,516. In addition, the taxpayers had a net operating loss carryforward to 1986, in the amount of $75,530.

The Commission concluded as follows:

A. The 1986 income earned by the taxpayers in the form of wages or salaries paid by Pedersen Farms did not constitute "nonfarm Wisconsin adjusted gross income" for purposes of calculating any farm loss addition modification under sec. 71.05(1)(a)26, Wis. Stats. (1985-86).

B. The department correctly applied the taxpayers' Wisconsin net operating loss carryforward in its calculation of 1986 income tax due.

Neither the department nor the taxpayer have appealed this decision. □

## CORPORATION FRANCHISE AND INCOME TAXES

**Allocation of income — business or nonbusiness income.** *Wisconsin Department of Revenue vs. Citizen Publishing Co. of Wisconsin, Inc.* (Court of Appeals, District IV, May 26, 1994). The department appealed an order of the Circuit Court for Dodge County which upheld a Wisconsin Tax Appeals Commission decision dated May

6, 1992. See *Wisconsin Tax Bulletin* 81 (April 1993), page 10, for a summary of the Circuit Court's decision.

The issues in this case are as follows:

A. For taxable years 1982 through 1984, was the income the taxpayer derived from the rental of printing equipment in Minnesota "business" income within the meaning of Wis. Adm. Code sec. Tax 2.39(6)?

B. For taxable year 1981, did the department erroneously allocate to the taxpayer's Minnesota rental income expenses incurred by the taxpayer in the regular course of its printing business?

Citizen Publishing Co. of Wisconsin, Inc. (Citizen) publishes and prints a daily newspaper in Beaver Dam, Wisconsin, and does commercial printing. In 1979, Citizen leased and equipped an empty plant in New Hope, Minnesota. It began printing advertising inserts at the facility. Citizen ended its Minnesota printing operations in April 1980 and never resumed such operations.

Thereafter, Citizen and a Nebraska corporation, Snell Publishing Company, incorporated a Minnesota corporation, Lithoweb, Inc. Citizen and Snell each owned fifty percent of its stock. Lithoweb subleased the New Hope real estate from Citizen. Citizen modified the plant equipment and leased it to Lithoweb for a term of ten years. Neither Citizen nor any of its officers, employes, or shareholders were involved in the day-to-day operation of Lithoweb.

Lithoweb was responsible for the taxes, insurance, and maintenance charges on the equipment. Citizen occasionally contracted with Lithoweb to service and repair the equipment. However, generally Citizen's involvement with Lithoweb consisted of receiving rent and minimal monthly bookkeeping.

For taxable year 1981, Citizen and the department treated the income from the rental of the printing equipment to Lithoweb as allocable to Minnesota under sec. 71.07(1m), Wis. Stats. (1979-80). After the statute was amended in 1981, the department treated Citizen's 1982 through 1984 rental income as apportionable and assessed additional taxes and interest.

The Commission held that Citizen's rental activity in Minnesota did not arise in the regular course of its printing business but "was clearly a passive and isolated lease transaction entered into by [Citizen] in an attempt to utilize idle printing equipment left from an earlier failed business transaction." The Commission found it significant that the parties stipulated that for purposes of this case, Citizen and Lithoweb do not constitute a unitary business. The Commission did not view Citizen's joint venture with Snell Publishing as continuing Citizen's publishing business but solely as a rental arrangement. Because Citizen is not in the rental business, the Commission held that its joint venture with Snell was not conducted in the regular course of its trade or business.

Citizen stipulated that its 1981 interest expense and depreciation on the leased equipment were properly allocated to Minnesota. However, it disputed the department's allocation of a percentage of its company-wide data processing, accounting, and administrative expenses to Minnesota. The department allocated approximately four percent or $26,824 of these expenses to Citizen's Minnesota rental income. The Commission held that the department made no showing that these were "related expenses" as required by sec. 71.07(2), Wis. Stats. (1979-80).

The Court of Appeals affirmed the Circuit Court's decision that the 1982 through 1984 rental income was not "business" income, concluding that the Commission's construction of Wis. Adm. Code sec. Tax 2.39(6) was reasonable. In addition, the Court of Appeals found that the Commission correctly concluded that the department erred when it allocated a percentage of Citizen's company-wide expenses to Citizen's rental income from the lease to Lithoweb.

The department has not appealed this decision. □

**Apportionable income; Unitary business; Dividends — deductible dividends.** *Albany International Corp. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 23, 1994). The issues in this case are as follows:

A. Was the department's inclusion in the taxpayer's apportionable income of interest and dividends received from majority-owned subsidiaries proper under sec. 71.07(1m)(b)9, Wis. Stats. (1985), and under the Due Process or Commerce Clauses of the U.S. Constitution?

B. Was the department's inclusion in the taxpayer's apportionable income of interest and dividends received from sources other than such subsidiaries proper under sec. 71.07(1m)(b)9, Wis. Stats. (1985), and under the Due Process or Commerce Clauses of the U.S. Constitution?

C. Was the department's inclusion in the taxpayer's apportionable income of royalties received proper under sec. 71.07(1m)(b), Wis. Stats. (1985), and under the Due Process or Commerce Clauses of the U.S. Constitution?

D. Was the department's inclusion in the taxpayer's apportionable income of capital gains received proper under sec. 71.07(1m)(b)9, Wis. Stats. (1985), and under the Due Process or Commerce Clauses of the U.S. Constitution?

E. Was the department's inclusion in the taxpayer's apportionable income of dividends, interest, royalties, and gain received by the taxpayer from foreign corporations violative of the Foreign Commerce Clause of the U.S. Constitution?

F. Was the inclusion in the taxpayer's apportionable income of dividends, interest, royalties, and gains without the proceeds received by the taxpayer from the sale of intangible assets, and the property, payroll, and sales of the payor corporations and the divested corporations giving rise to the gains being represented in the Wisconsin apportionment factors of the taxpayer violative of the Due Process or Commerce Clauses of the U.S. Constitution?

G. Was the inclusion in the taxpayer's apportionable income of dividends received by the taxpayer from corporations that apportion less than 50% of their income to Wisconsin violative of the Commerce or Equal Protection Clauses of the U.S. Constitution?

H. Is the department required to pay the taxpayer's legal fees and costs by reason of 42 U.S.C. secs. 1983 and 1988?

Albany International Corp. (AI) is a Delaware corporation, with its principal place of business in Albany, New York. During the period under review, 1981 through 1986, AI's main business was the design, manufacture, and marketing of woven fabrics known as "paper machine clothing." "Paper machine clothing" is custom designed fabric installed in papermaking machines to carry paper stock through each stage of the production process. The papermaking process involves the forming of paper stock into a continuous sheet of paper or paperboard and the removal of most of the water from the paper stock.

A papermaking machine has three sections (forming, pressing, and drying) with a total of 12 to 15 individual positions, each of which requires paper machine clothing. AI manufactures clothing for each of the three sections of the papermaking machine.

Appleton Wire is the only U.S. division of AI that manufactures forming fabrics. At all times relevant, Appleton Wire's business was the manufacture of forming fabrics used in the papermaking process and of industrial process fabrics used to manufacture disposable diapers and other paper products. Appleton Wire has two plants in Wisconsin, one in Tennessee, and one in Alabama.

During the period under review, except as otherwise noted, AI owned nearly all of the outstanding capital stock of 11 subsidiaries (the "Subsidiaries") which, with one exception, manufactured and sold paper machine clothing throughout the world primarily for markets in the subsidiaries' part of the world. AI received dividends, interest income, and royalties from the Subsidiaries, all of which were included by the department in AI's Wisconsin apportionable income.

AI controlled the operation of its domestic operations and the Subsidiaries through three senior vice presidents, an executive vice president, a president and chief executive officer, and the chairman of the AI Board of Directors. Operating plans for Subsidiaries and divisions were presented to the senior operating management of AI for approval. The final version of the operating plan had to be approved by the AI chairman of the board and by its president, after consultation with the responsible senior vice president. Subsidiaries and divisions could not make expenditures in excess of $30,000 without the approval of the senior vice president for the area or the AI president.

AI had a policy manual which contained a variety of policies applicable to the Subsidiaries. The policies were general guidelines, and some were regarded more seriously than others by AI's senior management.

AI and its Subsidiaries were functionally integrated, particularly with respect to the development and sharing of new products and technology. AI had its major research facility for the development of new products and manufacturing processes in the United States. In addition, its Swedish subsidiary had a research facility. AI had technical services agreements with its Subsidiaries, whereby the subsidiary paid AI an amount equal to a percentage of its gross sales as royalties for the use of AI technology.

There was also functional integration with respect to provision by AI of management services to the Subsidiaries, for which AI charged a pro rata management fee.

Although AI did not generally guarantee or secure loans for its Subsidiaries, it did so for Australia in the years 1982 through 1986, for Holland in 1983 and 1984, and for Canada in 1984 through 1986. AI received interest on loans it made to the Subsidiaries.

AI and its subsidiaries' worldwide operations produced economies of scale. Its greatest economy was to utilize its research facilities to devel-

op new products and processes, and then to produce and sell its products in a manner customized to paper makers in particular markets in the world. In this way it improved its market share through its name identification, technologically advanced products efficiently produced, and its delivery services. Besides economies of scale in research (i.e., many units sharing the cost of research), it achieved economies by many units sharing corporate services of its centralized management. It achieved economies by being able to produce products at its most efficient unit and by supplying the products to a subsidiary in another area market for resale, at a profit to both. In addition, it achieved economies in advertising, worldwide insurance coverage, accounting and auditing, quality assurance, and environmental policy.

During the years 1982 through 1986, AI owed minority percentages of the outstanding capital stock of six companies (the "Affiliates") and reported for federal income tax purposes dividends from the Affiliates, all of which were included by the department in AI's Wisconsin apportionable income.

AI received royalty income from the Affiliates, all of which was included by the department in AI's Wisconsin apportionable income.

There was neither centralized management nor functional integration between AI and the Affiliates. None of the Affiliates submitted to AI operating plans of the type submitted by the Subsidiaries, nor were the Policy Manual or the Accounting Manual applicable to the Affiliates. Economies of scale with respect to the Affiliates were limited.

During the period 1984 through 1986, AI reported interest income from "IPG Notes" and "Installment Lease." The "IPG Notes" were received by AI from Charterhouse upon Charterhouse's purchase of the assets of AI's Industrial Products Division in December 1983. The interest income associated with the IPG Notes was the accrued interest earned by AI on the promissory notes that it accepted as partial payment on the sale of the Industrial Products Division assets. Charterhouse, as the buyer, was in no way related to AI.

The "Installment Lease" on which AI accrued interest is an agreement between AI, as lessor of certain real property it owned in Georgia, and an unrelated plastics company, as lessee. The lessee became bankrupt in 1985, and, as a result, there were "negative interest" adjustments in 1985 and 1986 which reflected negative adjustments to interest income that had previously been accrued.

Lastly, the parties agree that interest AI received from banks, other intercompany loans, municipal bonds, and other resources shall be included in apportionable income.

During the period 1982 through 1986, AI reported royalty income, all of which was included by the department in AI's apportionable income. Scentry, BI Industries, Kimre, and Millipore License were all companies unrelated to AI and engaged in businesses other than the paper machine clothing business. The royalty payments made by these companies to AI were for the license of technology which was unrelated to the paper machine clothing industry.

AI reported royalty income from Lindsey, Nippon Felt, BTR Huyuk, and JWI, which were all unrelated to AI and were direct competitors of AI in the paper machine clothing business. The royalties paid by these companies to AI were for the license of technology related to the paper machine clothing industry.

AI also reported royalty income from Beier, a partnership with operations in South Africa. The partnership was owned 50% by AI and 50% by a South African company, OTH Beier. The operation involved the manufacture and sale of certain paper machine clothing and industrial products, primarily in South Africa. OTH Beier provided the day-to-day operating management of the partnership, and the only contact AI had with the operations were occasional visits and contacts by phone.

AI reported capital gains on the sale of assets, all of which were included by the department is AI's apportionable income. The gains reported by AI on the sale of "trade secrets" in the years 1982 through 1984 resulted from the sale of technology that was developed by the Research and Development Division of AI located in Massachusetts. The technology related to ultra or microfiltration of liquids and gasses through membrane structures and was entirely unrelated to AI's principal business of paper machine clothing. The technology was sold to Millipore License, a company wholly unrelated to AI.

The $115,000 gain reported in 1985 related to the sale of a division of AI located in Albany, New York, which was then the only domestic manufacturer of billiard balls. The sale was made to a company which was wholly unrelated to AI.

The $94,000 gain reported by AI in 1986 resulted from the redemption of a note held by AI in connection with the sale to an unrelated company of certain assets in 1983. The amount received by AI upon the redemption of the note exceeded the face value of the note and constituted a gain.

The amounts reported by AI in 1985 and 1986 relating to the transfer of its interests in Finland and Norway are

amounts that were also reported by AI as dividends received from Sweden. Until September of 1985, AI owned 100% of the outstanding stock of Sweden, 100% of the outstanding stock of Norway, and 50% of the outstanding stock of Finland. The remaining 50% of the stock of Finland was owned by Sweden. On September 30, 1985, AI transferred the 50% of the Finland stock which it owned to Sweden. On January 29, 1986, AI transferred 100% of the stock of Norway to Sweden.

The Commission reached the following conclusions:

A. The department's inclusion in the taxpayer's apportionable income of interest and dividends received from majority-owned Subsidiaries was proper. The taxpayer's operations were unitary with those of the Subsidiaries. The taxpayer was functionally integrated with the Subsidiaries, and the taxpayer had and exercised centralized management control over the Subsidiaries. The record also showed economies of scale. There was little doubt that there was a substantial "flow of value between the entities" and that the acquisition of the Subsidiaries by the taxpayer served "an operational rather than an investment function."

B. The department's inclusion in the taxpayer's apportionable income of interest and dividends received from other sources was not proper. Except for some of these payor entities being engaged in the same line of business as the taxpayer, no characteristics of unitariness with the taxpayer were present during the period under review. These other payor entities did not serve "an operational rather than an investment function" and their activities were unrelated to those of the taxpayer in Wisconsin, therefore failing those critical tests of unitariness and apportionability set forth in the *Allied-Signal* and *Container* cases. Under these circumstances, the Commerce Clause and the Due Process Clause prohibit state apportionment of this dividend and interest income.

C. The department's inclusion in the taxpayer's apportionable income of royalties was proper. The royalty income was the result of technology and processes developed by the taxpayer's domestic research division, which was related to and supportive of its sister Appleton Wire division activities in Wisconsin and elsewhere. Although the royalties were paid by companies unrelated to the taxpayer, there was no showing by the taxpayer that the income "was earned in the course of activities unrelated to" the taxpayer's activities in Wisconsin. Under these circumstances, unitariness between the taxpayer and the payor is unnecessary, and the royalty income is properly apportionable under secs. 71.07(1m)(b)6 and/or 21, Stats. (1985-86).

D. The department's inclusion in the taxpayer's apportionable income of capital gains received was proper, except as to the gains from the sale of the taxpayer's Nordic subsidiaries, which the department properly included as apportionable dividend income.

   Because the gains on the sale of trade secrets were from the sale of technology developed as a by-product of the taxpayer's domestic research division, which was related to and supportive of its Appleton Wire division activities in Wisconsin, no further unitary analysis is needed to conclude that this is apportionable income.

   Because the gain on the sale of Albany Billiard was from the sale of an operational division which was an asset of the taxpayer's business and a sister to the Appleton Wire division in Wisconsin, it was by its organizational nature unitary with the taxpayer, just as was the Wisconsin-based Appleton Wire division. No analysis of unitariness with the payor/purchaser is required.

   The taxpayer's evidence at the hearing showed that the capital gains relating to the transfer of interests in its Finland and Norway subsidiaries in 1985 and 1986 were included in amounts reported by the taxpayer as dividends received from Sweden. These amounts were, therefore, properly included by the department as dividends from unitary subsidiaries which were apportionable.

   The gain on the redemption of the note resulted from a sale of assets to an unrelated company. Because the assets sold were business assets of the taxpayer's domestic business, which included its Wisconsin operations, and because there was no showing by the taxpayer that the gain was unrelated to its Wisconsin operations, the gain is properly apportionable.

E. The inclusion in the taxpayer's apportionable income of dividends, interest, royalties, and gain received by the taxpayer from foreign corporations did not violate the Foreign Commerce Clause of the U.S. Constitution.

F. The inclusion in the taxpayer's apportionable income of dividends, interest, royalties, and gains without the proceeds received by the taxpayer from the sale of intangible assets, and the property, payroll, and sales of the

payor corporations and the divested corporations giving rise to the gains being represented in the Wisconsin apportionment factors did not violate the Due Process or Commerce Clauses of the U.S. Constitution.

G. The department's inclusion in the taxpayer's apportionable income of dividends received by the taxpayer from corporations that apportion less than 50% of their income to Wisconsin violates the Interstate Commerce Clause of the U.S. Constitution.

H. Since there is not Wisconsin statutory provision authorizing the Commission to award attorneys fees and expenses pursuant to 42 U.S.C. sec. 1988, the Commission lacks subject matter jurisdiction to do so and must deny the taxpayer's claim.

Both the department and the taxpayer have appealed this decision to the Circuit Court. □

**Foreign sales corporations (FSCs).** *Kimberly-Clark Corporation as successor to Kimtech Ltd. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, April 12, 1994). The issue in this case is whether the taxpayer is entitled to deduct the sales commissions it paid to Kimberly-Clark Sales Corporation during the years 1985, 1986, and 1987 or, stated another way, whether that foreign sales corporation was a mere "paper" corporation with no real economic substance.

Kimberly-Clark Corporation is the successor to Kimtech Ltd. as a result of Kimtech Ltd.'s liquidation into the taxpayer on January 1, 1988. Kimtech Ltd., a wholly owned subsidiary of Kimberly-Clark Corporation, was a Delaware corporation with its principal place of business in Neenah, Wisconsin. Kimtech Ltd. designed, manufactured, and installed machinery, and provided mechanical maintenance service.

Kimberly-Clark Sales Corporation (Sales) was incorporated on November 20, 1984, under the laws of the Virgin Islands. Kimberly-Clark Corporation (Kimberly-Clark) is the sole shareholder of Sales. For the years at issue, Sales qualified as a foreign sales corporation (FSC) under section 922 of the Internal Revenue Code. Sales was formed for the purpose of centralizing export operations, increasing foreign sales, increasing profitability of exports, and obtaining the benefits accorded under sections 926-927 of the Internal Revenue Code in order to be more competitive with foreign sellers in compliance with the General Agreement on Tariffs and Trade (GATT).

Sales was party to an Export Services Agreement with the taxpayer whereby, in return for a sales commission, Sales agreed to perform or have performed certain services with respect to the taxpayer's export sales.

Kimtech Ltd. reported a FSC commission expense to Sales of $18,350 for 1985, $2,387 for 1986, and $16,296 for 1987. The department has denied a deduction for all commissions paid to Sales.

Sales had its own officers and directors. Its officers and directors were all employes of Kimberly-Clark or its affiliates, with the exception that one citizen of the Virgin Islands was named as a director to fulfill the minimum legal requirements to obtain the tax benefits of the FSC.

During 1985, Sales leased an office in St. Thomas, Virgin Islands. Sales owned office equipment located in the office and leased other equipment. The office was staffed by a full-time resident employe who devoted all his time to the activities of Sales and was paid by Sales. The books and records of Sales were maintained at this office.

For 1986 and 1987, Sales moved its office to The Netherlands. There, it rented office space and business services from Kimberly-Clark Benelux under a Services and Facilities Agreement. Pursuant to the agreement, Sales obtained the services of John Schuller, who devoted approximately one-half of his time to the business of Sales, and obtained the services of other personnel as required.

Sales maintained bank accounts in both the Virgin Islands and in The Netherlands with substantial cash balances.

Sales conducted substantial business activities in its own right, including mailing thousands of catalogs, price lists, and other advertising and promotional materials to potential customers of Kimberly-Clark's exporting units. In addition, it answered inquiries from customers or forwarded them to the appropriate Kimberly-Clark unit. It mailed order acknowledgements to customers, which were the formal acceptance of the customers' orders. It incurred a variety of normal business expenses and paid those expenses from its own accounts. It paid its own taxes, including substantial U.S. taxes and payments to the Virgin Islands and The Netherlands.

In addition, Sales had performed on its behalf other export-related activities by various selling units of Kimberly-Clark pursuant to Export Services Agreements. Under these agreements, the operating units acted as the agent of Sales. Such services were compensated on an arm's-length basis, and the commissions to which Sales was entitled were determined on an arm's-length basis.

Virtually all of Kimtech Ltd.'s customers were affiliates of Kimberly-Clark or Kimberly-Clark itself. All of Kimtech Ltd.'s foreign customers were affiliates of Kimberly-Clark.

Wisconsin did not federalize its corporate income and franchise tax system until 1987. When Wisconsin did federalize its corporate income and franchise tax system, it provided a specific modification of federal adjusted gross income under sec. 71.26(3)(r), Wis. Stats., because it did not recognize IRC sections 921-927 (FSC) as part of the Internal Revenue Code for computation of a corporation's income for Wisconsin income tax purposes.

By definition under federal FSC law, Sales had economic substance. In operative terms, it also was more than a mere "paper" corporation in many respects, including but not limited to the following. Sales:

- had its own officers and directors;
- had employes and offices, either directly or via service agreements;
- maintained substantial active bank accounts;
- conducted business activities in its own right;
- incurred and paid taxes;
- paid its own organizational costs.

In both form and substance Sales, unlike Kohler under previous DISC legislation, was a viable business enterprise.

The Commission concluded that Sales was a separate corporation formed for substantial business reasons and which carried on substantial business activities. It earned the commissions paid to it, and there is no basis for denying the taxpayer a deduction for such commissions. There is no basis under Wis. Stats. sec. 71.11(7m), applicable to 1985, and sec. 71.30(2), applicable to 1986 and 1987, for reallocating the commission income of Sales to the taxpayer.

The department has not appealed this decision. □

## SALES AND USE TAXES

**Coin-operated laundry machines.** *Charles M. Malone vs. Wisconsin Department of Revenue* (Circuit Court for Eau Claire County, March 31, 1994). This is a review of a decision by the Wisconsin Tax Appeals Commission. For a summary of that decision, see *Wisconsin Tax Bulletin* 82 (July 1993), page 26.

The issues in this case are:

A. Whether sec. 77.52(2)(a)6, Wis. Stats., exempts from sales tax the gross receipts from washers and dryers which are activated by tickets and not by coins.

B. If not, whether the department should be estopped from collecting the sales tax from the taxpayer.

C. Whether the department has retroactively applied sec. Tax 11.72, Wis. Adm. Code, to the taxpayer.

The taxpayer is the sole proprietor of a self-service laundry business which contains both ticket-operated and coin-operated washers and dryers. The taxpayer consulted various tax professionals to determine whether his self-service, ticket-operated laundry machines were subject to sales and use tax, but he did not request the opinion of the Department of Revenue. The department assessed additional sales and use taxes to the taxpayer for the period of January 1987 through December 1990.

The Circuit Court concluded as follows:

A. Because the taxpayer's machines are ticket-operated, he has not brought himself within the clear and unambiguous language of sec. 77.52(2)(a)6, Wis. Stats.

   Section 77.52(2)(a)6, Wis. Stats is a narrow exemption to sales and use tax which exempts laundry services when three elements are present:

   1) The service must be performed by the customer;

   2) The service must be performed on a coin-operated machine; and

   3) The machine must be a self-service machine.

B. Estoppel is not applicable in this case. There are three elements of estoppel:

   1) Action or non-action by the party to be held estopped;

   2) Reliance on that action or non-action by the individual seeking estoppel; and

   3) Detrimental reliance on the action or non-action by the individual seeking estoppel.

C. The Tax Appeals Commission correctly found there was no retroactive application in this case. The rule, sec. Tax 11.72(1)(b), Wis. Adm. Code, does not alter the requirements of the statute.

The taxpayer has not appealed this decision. □

**Exemptions — water, bottled.** *Artesian Water Company, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, April 8, 1994). The issue in this case is whether the taxpayer's sales of bottled artesian spring water qualify for exemption from sales and use tax under sec. 77.54(20), Wis. Stats.

The taxpayer is a Wisconsin corporation and since its inception in 1986 has been primarily engaged in the sale of bottled artesian spring water. During the periods involved herein, the taxpayer did not collect and/or remit sales tax on its primary product.

The key question to resolve is whether the taxpayer's primary product, bottled artesian spring water, is a "beverage for human consumption" within the intent and meaning of sec. 77.54(20)(a), Wis. Stats. The bottled water in question was destined for human consumption, leaving for the Commission's determination only whether or not it is a "beverage."

Section 134.77(1)(a), Wis. Stats., defines "beverage" to include bottled drinking water, as defined under sec. 97.34(1)(a), Wis. Stats. That section defines "bottled drinking water" as "... all water packaged in bottled or similar containers and sold or distributed for drinking purposes. This term includes distilled water, artesian water, spring water and mineral water, whether carbonated or uncarbonated."

Section Tax 11.51(2)(a), Wis. Adm. Code, provides that sales of bottled water are subject to sales tax.

The Commission concluded that bottled artesian spring water is a "beverage for human consumption" within the intent and meaning of sec. 77.54(20)(a), Wis. Stats. and is, therefore, exempt from sales tax. An administrative rule may not supersede a statute, and the Commission determined that sec. Tax. 11.51(2)(a), Wis. Adm. Code, supersedes the statute as far as bottled artesian spring water is concerned.

The Commission also concluded that the legislature, in enacting sec. 77.54(20), Wis. Stats., did not intend to exempt beverages like milk and juice but not water.

The department has not appealed but has adopted a position of nonacquiescence in regard to this decision. □

**Successor's liability.** *Robert Kastengren vs. Wisconsin Department of Revenue* (Court of Appeals, District IV, October 7, 1993). This is an appeal from an order of the Circuit Court for Dane County. For a summary of the Circuit Court decision, see *Wisconsin Tax Bulletin* 78 (July 1992), page 11.

The issue is whether the taxpayer, as the purchaser of Uncle Harry's Fine Food Products, Inc. (UHFFP), is personally liable for UHFFP's unpaid sales and use taxes.

On December 22, 1988, the taxpayer entered into an "Asset Purchase Agreement" with Harry Dembroski to purchase UHFFP's equipment and inventory. UHFFP owed sales tax to the state. The taxpayer paid the purchase price to UHFFP and its secured creditor, the Bank of Burlington. The bank received all of the proceeds of the purchase price. The taxpayer did not withhold any of the proceeds to pay the unpaid taxes and did not submit to the department a written request for a sales and use tax clearance certificate.

The department could document eleven contacts with UHFFP attempting to collect the delinquent taxes. However, the department ceased its efforts to collect the taxes from UHFFP because it concluded that the corporation was defunct and had no assets. The department did not attempt to collect the taxes from Harry Dembroski.

On August 30, 1989, the department assessed delinquent sales taxes against the taxpayer, who petitioned the department to redetermine the assessment on the grounds that his liability was abated by his payment of the purchase price to UHFFP's secured creditor, and on the further grounds that the department had not first proceeded against Dembroski.

The Circuit Court ruled that the department could not direct collection efforts against the taxpayer until it had attempted to collect the unpaid sales taxes from Dembroski.

The Court of Appeals concluded that the language of sec. 77.52(18), Wis. Stats. and sec. Tax 11.91(4), Wis. Adm. Code, unambiguously make the taxpayer, as purchaser of UHFFP's business and inventory, liable for UHFFP's unpaid sales taxes.

In view of the purpose of sec. 77.52(18), Wis. Stats., the department could reasonably construe "predecessor" as used in sec. Tax 11.91(4), Wis. Adm. Code to refer to the retailer who "quits the business."

The Court of Appeals further concluded that the Commission had correctly ruled that the taxpayer was not excused from complying with sec. 77.52(18), Wis. Stats., merely because UHFFP's secured creditor had a lien against the corporation's equipment and inventory, which equalled or exceeded the purchase price.

The taxpayer has not appealed this decision. □

# Tax Releases

*"Tax releases" are designed to provide answers to the specific tax questions covered, based on the facts indicated. 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 Credit for Tax Paid to California

**Statutes:** Section 71.07(7), Wis. Stats. (1991-92)

**Wis. Adm. Code:** Section Tax 2.955, April 1993 Register

**Background:** Section 71.07(7), Wis. Stats. (1991-92), provides that "If a resident individual, estate or trust pays a net income tax to another state, that resident individual, estate or trust may credit the net tax paid to that other state on that income against the net income tax otherwise payable to the state on income of the same year." The credit is allowed only if the income taxed by the other state is also considered income for Wisconsin tax purposes.

The State of California operates a State Disability Insurance (SDI) system which is funded entirely by contributions deducted from wages of nonexempt employes or from employer contributions made on behalf of employes. All employes who are not exempt must contribute to the SDI unless their employer establishes a suitable private disability plan which meets State requirements. For 1992, the SDI contribution was equal to 1.25% of the employe's gross wages, subject to a maximum amount.

In Rev. Rul. 81-194, the Internal Revenue Service indicates that amounts withheld from wages of employes for contributions to the California SDI system qualify as "income taxes" of a state and are deductible under sec. 164, IRC, as an itemized deduction. This Revenue Ruling is consistent with the decision in Anthony and Delia Trujillo v. Commissioner of the Internal Revenue Service, 68 TC 651, August 3, 1977.

**Facts and Question:** The taxpayer is a full-year Wisconsin resident who works as an employe in California during the year. The taxpayer is required to contribute to the California SDI system based on his wages, which are taxable to both Wisconsin and California. May the taxpayer claim a credit for net income tax paid to other states on his Wisconsin income tax return for the amount paid to the California SDI system?

**Answer:** Yes, the California SDI system payment is eligible for the credit as "income tax" paid to another state. The tax is determined on the basis of a percentage of gross wages and is subject to a maximum wage limitation. The tax is paid "to another state" and is paid "on income taxed by the other state that is also considered income for Wisconsin tax purposes." □

### 2 Interest Received by a Nonresident From a Nonqualified Deferred Compensation Plan

**Statutes:** Section 71.04(1), Wis. Stats. (1991-92)

**Wis. Adm. Code:** Section Tax 3.085, June 1990 Register

**Background:** Section 71.04(1)(a), Wis. Stats. (1991-92), provides that income from personal services of nonresident individuals shall follow the situs of the services. Interest

income received by a nonresident individual shall follow the residence of the individual.

Wisconsin Administration Code sec. Tax 3.085 provides that distributions from a *qualified* retirement plan or *qualified* deferred compensation plan received by a person while a nonresident of Wisconsin are exempt from Wisconsin tax, regardless of whether the distribution may be attributable to personal services performed in Wisconsin. Distributions received by a nonresident of Wisconsin from a *nonqualified* retirement plan or *nonqualified* deferred compensation plan are taxable to Wisconsin if the payment is attributable to personal services performed in Wisconsin (see the tax release titled "Distribution From a Nonqualified Retirement Plan or Nonqualified Deferred Compensation Plan to a Nonresident of Wisconsin" in *Wisconsin Tax Bulletin* 82 (July 1993), page 28).

**Facts and Question 1:** A nonresident of Wisconsin receives a distribution from a nonqualified deferred compensation plan. The distribution consists of deferred wages from personal services performed in Wisconsin and interest income which was credited to the deferred compensation account. Is the interest income portion of the distribution from the nonqualified deferred compensation plan taxable to Wisconsin when received by a nonresident?

**Answer 1:** No, the interest income portion of a nonqualified deferred compensation plan distribution is not taxable to Wisconsin when received by a nonresident of Wisconsin. Only the portion of the distribution attributable to payment for personal services performed in Wisconsin is taxable to Wisconsin when received by a nonresident of Wisconsin.

**Question 2:** The balance in a nonqualified deferred compensation account may be distributed over a period of years. When a distribution received by a nonresident of Wisconsin consists of both income from personal services performed in Wisconsin and interest income, what portion of the distribution is interest income?

**Answer 2:** The interest income portion of a distribution from a nonqualified deferred compensation plan may be determined by using the following formula:

$$\text{Amount distributed from the nonqualified deferred compensation plan during the year} \times \frac{\text{Total interest credited to the nonqualified plan for all years minus the amount of interest withdrawn in prior years}}{\text{Total value of the nonqualified deferred compensation plan at the end of the year plus amounts distributed during the year}}$$

**Example 1:** On January 1,1993, Mr. X retired and became a resident of Florida. Mr. X had been a participant in his employer's nonqualified deferred compensation plan, and had deferred $100,000 of wages earned in Wisconsin. As of January 1, 1993, a total of $30,000 of interest had been credited to X's account. During 1993 an additional $7,500 of interest was credited. The account balance on December 31, 1993 was $123,500.

Mr. X received a distribution of $14,000 from the plan during 1993; $3,818 of that amount represents interest and is not taxable to Wisconsin. The balance ($10,182) of the distribution is attributable to personal services performed in Wisconsin and must be included in X's 1993 Wisconsin taxable income. The portion attributable to interest is computed as follows:

$$\$14{,}000 \times \frac{\$37{,}500}{\$137{,}500} = \$3{,}818^*$$

*portion attributable to interest

The following worksheet illustrates the use of the formula:

| | |
|---|---|
| 1. Amounts distributed from the nonqualified deferred compensation plan during the year . . | $ 14,000 |
| 2. Total interest received by the nonqualified deferred compensation plan for all years minus the amount of interest withdrawn in prior years . . . . . | $ 37,500 |
| 3. Total value of the nonqualified deferred compensation plan at the end of year plus amount on line 1 ($123,500 + $14,000) . . . . | $137,500 |
| 4. Divide line 2 by line 3. Enter decimal figure . . . . . | .2727 |
| 5. Multiply line 1 by line 4. This is the amount of the distribution from the nonqualified deferred compensation plan which is considered interest . . . . . | $ 3,818 |

**Example 2:** During 1994, the taxpayer in Example 1 received an additional distribution of $14,000 from the nonqualified deferred compensation plan. Mr. X's account was also credited with $6,500 of interest income for 1994. The account balance on December 31, 1994 was $116,000.

A portion of the amount X received during 1994 ($4,327) represents interest and is not taxable to Wisconsin. The

balance ($9,673) of the distribution is attributable to personal services performed in Wisconsin and must be included in X's 1994 Wisconsin taxable income. The portion attributable to interest is computed as follows:

$$\$14,000 \times \frac{(\$37,500 + \$6,500) - \$3,818}{\$130,000} = \$4,327^*$$

*portion attributable to interest

The following worksheet illustrates the use of the formula:

1. Amounts distributed from the nonqualified deferred compensation plan during the year . . $ 14,000
2. Total interest received by the nonqualified deferred compensation plan for all years minus the amount of interest withdrawn in prior years ($37,500 + $6,500 - $3,818) . . . $ 40,182
3. Total value of the nonqualified deferred compensation plan at the end of year plus amount on line 1 ($116,000 + $14,000) . . . . $ 130,000
4. Divide line 2 by line 3. Enter decimal figure . .3091
5. Multiply line 1 by line 4. This is the amount of the distribution from the nonqualified deferred compensation plan which is considered interest . . . . . $ 4,327

□

## 3 Medical Care Insurance Deduction

**Statutes:** Section 71.05(6)(b)17 and 18, Wis. Stats. (1991-92), as amended by 1993 Wisconsin Act 16, and sec. 71.05(6)(b)19 and 20, Wis. Stats., as created by 1993 Wisconsin Act 16

**Note:** This tax release applies only with respect to taxable years beginning on or after January 1, 1993.

**Background:** For taxable years beginning in 1993, sec. 71.05(6)(b)17, Wis. Stats. (1991-92), provides a deduction for 25% of the amount paid for medical care insurance by a self-employed person or by a person who is an employe if the person's employer pays no amount of money toward the person's medical care insurance for the person, his or her spouse, and dependents. The deduction is claimed as a subtraction from federal adjusted gross income when computing Wisconsin taxable income.

The deduction for 25% of the amount paid for medical care insurance is limited to the person's aggregate net earnings from a trade or business that are taxable to Wisconsin. A nonresident or part-year resident of Wisconsin (a person not domiciled in Wisconsin for the entire year) must prorate the deduction by multiplying the amount by a fraction the numerator of which is the person's net earnings from a trade or business taxable by Wisconsin and the denominator of which is the person's total earnings from a trade or business.

"Medical care insurance" means a medical care insurance policy that covers the person, his or her spouse, and dependents and provides surgical, medical, hospital, major medical, or other health service coverage, and includes payments made for medical care benefits under a self-insured plan. "Medical care insurance" does not include hospital indemnity policies or policies with ancillary benefits such as accident benefits or benefits for loss of income resulting from a total or partial inability to work because of illness, sickness, or injury.

For taxable years beginning in 1994, the deduction will increase to 50% of the amount paid for medical care insurance for both a self-employed person and a person who is an employe whose employer pays no amount toward the person's medical care insurance. For taxable years beginning in 1995 and thereafter, the deduction will remain at 50% of the amount paid for medical care insurance by a person who is an employe, but will increase to 100% for a self-employed person.

**Facts and Question 1:** The taxpayer is employed by ABC Corporation. ABC Corporation pays 90% of its employes' basic health insurance premiums. ABC Corporation also offers a catastrophic health insurance plan for which it does not pay any portion of the cost.

During 1993, the taxpayer pays a total of $600 for medical care insurance. The $600 includes $500 as the taxpayer's share of the cost of the basic health insurance ($4,500 paid by ABC Corporation) and $100 for the catastrophic health insurance. Does the taxpayer qualify for the deduction for 25% of medical care insurance costs?

**Answer 1:** Yes, however the deduction is based only on the amount paid for the catastrophic health insurance. The qualification for the deduction is determined on a policy-by-policy basis. The $500 paid by the taxpayer for the basic health insurance premium cannot be used in computing the deduction because the employer paid a portion of the premium. Because the employer did not pay any portion

of the premium for the catastrophic health insurance, the entire amount paid by the employe for this insurance ($100) can be used in computing the deduction. The taxpayer may claim $25 ($100 x .25) as the medical care insurance deduction.

(Note: The amount of medical care insurance claimed as a deduction cannot be used as a medical expense when computing the Wisconsin itemized deduction credit.)

**Question 2:** Does the cost of dental insurance qualify as "medical care insurance"?

**Answer 2:** Yes. Insurance that pays dental expenses is considered "medical care insurance."

**Question 3:** Can Medicare premiums paid be used in computing the deduction for 25% of medical care insurance costs?

**Answer 3:** Yes, premiums paid for Medicare B coverage by persons age 65 or over are payments for medical care insurance and can be used in the computation of the deduction, assuming all other qualifications are met. The Medicare B premium for an individual was $36.60 per month for 1993.

Caution: Medicare tax deducted from an individual's wages or paid by a self-employed individual is not considered a payment of medical care insurance and may not be used in the computation of the deduction.

A person who is not covered under social security (or was not a government employe who paid Medicare tax) may voluntarily enroll in Medicare A. In this situation, the premiums paid for Medicare A are considered medical care insurance premiums.

**Question 4:** In computing federal adjusted gross income on their personal returns, certain shareholders of S corporations and partners of partnerships are required to include as income medical care insurance premiums which the S corporation or partnership paid on their behalf. Can such shareholders or partners claim the Wisconsin deduction for 25% of the medical care insurance premiums included in their federal adjusted gross income?

**Answer 4:** Yes, assuming all other qualifications are met. An S corporation shareholder or partner is considered to have paid the premium in this situation.

**Facts and Question 5:** Taxpayer X's employer paid a portion of her medical care insurance during January and February 1993. Taxpayer X paid $200 toward the cost of her insurance during these 2 months. Taxpayer X changed jobs on March 1, 1993. The new employer did not provide any medical care insurance coverage. Taxpayer X obtained her own medical care insurance and paid premiums totaling $1,800 during March through December 1993. Can Taxpayer X claim the Wisconsin deduction for 25% of the medical care insurance premiums she paid during 1993?

**Answer 5:** Taxpayer X may claim a deduction of $450, based on the medical care insurance costs paid during March through December, 1993 ($1,800 x .25 = $450). Premiums for medical care insurance for January and February ($200) may not be used to compute Taxpayer X's deduction as her employer paid a portion of the premiums during that time. □

## 4 Preservation or Rehabilitation Project for the State Historic Rehabilitation Credit

**Statutes:** Section 71.07(9r), Wis. Stats. (1991-92), as amended by 1993 Wisconsin Act 16

**Background:** Section 71.07(9r)(a), Wis. Stats. (1991-92), provides a tax credit to individuals for 25% of the costs of preserving or rehabilitating certain historic property located in Wisconsin. The credit may not exceed $10,000, or $5,000 for married persons filing separately, *for any preservation or rehabilitation project.*

To qualify for the credit, the claimant must meet the following conditions:

1. The costs must be incurred by the owner of the property.
2. The costs must relate to preservation or rehabilitation work done to any of the following:
   (a) the exterior of the historic property,
   (b) the interior of a window sash if work is done to the exterior of the window sash,
   (c) structural elements of the historic property,
   (d) the heating or ventilating systems, or
   (e) electrical or plumbing systems, but not electrical or plumbing fixtures.
3. The property must be an owner-occupied personal residence.
4. The State Historical Society must certify that:
   (a) the property is listed on the National or Wisconsin Register of Historic Places or is located in a historic district and is of historic significance to the district,
   (b) the proposed preservation or rehabilitation plan complies with the Historical Society's standards, and
   (c) the completed preservation substantially complies with the proposed plan.

5. The preservation or rehabilitation work must be completed within 2 years after the date the physical work of construction or destruction in preparation for construction begins. However, for any preservation or rehabilitation initially planned for completion in phases, the work must be completed within 5 years.

6. The expenditures for preservation or rehabilitation must exceed $10,000.

7. The costs may not be incurred to acquire a building or interest in a building or to enlarge an existing building.

8. The costs must not be incurred before the Historical Society approves the proposed plan.

**Facts and Question:** Individual A owns and occupies a personal residence in Wisconsin which is listed on the National Register of Historic Places. The home's heating, plumbing, and electrical systems need to be replaced. In addition, the house needs a new roof, siding, and windows. The total cost of the rehabilitation work will exceed $40,000.

May Individual A separate the rehabilitation work into 2 or more preservation or rehabilitation projects in order to qualify for tax credits of up to $10,000 for each project?

**Answer:** Yes. Individual A may separate the rehabilitation work into 2 or more preservation or rehabilitation projects. The separate preservation or rehabilitation projects may run consecutively or concurrently. A tax credit would be available for 25% of the qualifying preservation or rehabilitation costs, but not more than $10,000, for each project.

For example, if the interior mechanical work and the exterior work are separated into 2 projects, and the qualifying preservation or rehabilitation costs for each project are $40,000, Individual A would be eligible for $20,000 of income tax credits ($10,000 for each project). □

## CORPORATION FRANCHISE AND INCOME TAXES

### 5 Dividends Received Deduction for Corporations

**Statutes:** Section 71.26(3)(j), Wis. Stats. (1991-92), as amended by 1993 Wisconsin Act 16

**Note:** For more information, see the tax release titled "Deductible Dividends Received From Subsidiaries" in *Wisconsin Tax Bulletin* 58 (October 1988), page 16.

**Background:** For taxable years beginning on or after January 1, 1993, a corporation may deduct dividends received from a corporation with respect to its common stock if the corporation receiving the dividends owns, directly or indirectly, during the entire taxable year at least 70% of the total combined voting stock of the payor corporation. To qualify for the deduction for taxable years beginning before January 1, 1993, the corporation was required to own, directly or indirectly, 80% or more of the total combined voting stock of the payor corporation.

**Facts and Question:** Corporation P does business in Wisconsin and files Wisconsin franchise tax returns on a calendar year basis. Corporation P owned 100% of the total combined voting stock in both Subsidiary S1 and Subsidiary S2 until July 1, 1993. On that date Subsidiaries S1 and S2 were merged into Corporation P. Thus, Corporation P owned them as divisions during the second half of the 1993 taxable year.

On March 15, 1993, and June 15, 1993, Subsidiary S1 paid Corporation P common stock dividends of $100,000 and $125,000, respectively. On each of these dates, Subsidiary S2 paid Corporation P common stock dividends of $200,000.

Are the $225,000 of dividends received from Subsidiary S1 and $400,000 of dividends received from Subsidiary S2 deductible by Corporation P in computing its 1993 Wisconsin net income?

**Answer:** No. Since Corporation P did not own, directly or indirectly, **during the entire taxable year** at least 70% of the total combined voting stock in Subsidiary S1 and at least 70% of the total combined voting stock in Subsidiary S2, the $225,000 of dividends received from Subsidiary S1 and $400,000 of dividends received from Subsidiary S2 are not deductible in computing its 1993 Wisconsin net income. □

### 6 Wisconsin Treatment of Section 179 Expense Deduction

**Statutes:** Sections 71.22(4) and (4m), 71.26(2) and (3), 71.34(1) and (1g), 71.42(2), 71.45(2), and 71.49(2), Wis. Stats. (1991-92), and as affected by 1993 Wisconsin Acts 16 and 437

**Background:** Under Internal Revenue Code (IRC) section 179, a corporation may elect to deduct as an expense, rather than depreciate, all or a portion of the cost of "section 179 property" that is placed in service during the taxable year. Section 179 property is new or used tangible personal property that is acquired by purchase for use in the active conduct of the taxpayer's trade or business. The section 179 expense deduction is subject to a dollar limitation and a taxable income limitation.

For taxable years beginning after December 31, 1992, the maximum section 179 expense deduction for most taxpayers is $17,500. The deduction was limited to $10,000 for taxable years beginning before January 1, 1993. The dollar limitation is reduced by the amount by which the cost of section 179 property placed in service during the taxable year exceeds $200,000. Members of a controlled group of corporations are treated as one taxpayer in applying the dollar limitation. A controlled group of corporations has the meaning in IRC sec. 1563(a), except that a more-than-50% (instead of an at-least-80%) control test applies. IRC sec. 179(d)(6). The dollar limitation amount can be allocated to the group members by the common parent corporation when the parent files a consolidated federal return. If separate federal returns are filed, the amount must be allocated according to an agreement made by the members. However, the amount of expense allocated to any group member cannot exceed the cost of the qualifying property actually purchased by the member and placed in service. Treas. Reg. §1.179-2(b)(7).

The section 179 expense deduction may not exceed the corporation's taxable income derived from the active conduct of a trade or business for the taxable year. The portion of the cost that may not be expensed for a taxable year because it exceeds the taxable income limitation may be carried forward for an unlimited number of years.

The election to claim the section 179 expense deduction must be made on the corporation's original federal income tax return filed for the taxable year in which the property was placed in service or on an amended return filed within the time prescribed by law, including extensions, for filing the return for that taxable year. Once made, the election and the selection of the property to be expensed may not be revoked without the consent of the Internal Revenue Service. Treas. Reg. §1.179-5.

**Question 1:** Does the increase in the section 179 expense deduction from $10,000 to $17,500 apply for Wisconsin franchise and income tax purposes? If so, when is it effective?

**Answer 1:** Yes. The increase in the section 179 expense deduction from $10,000 to $17,500 applies for Wisconsin purposes. It is effective at the same time as for federal purposes, applying to property placed in service in taxable years beginning after December 31, 1992.

The Wisconsin net income of a corporation is computed under the Internal Revenue Code as defined for Wisconsin purposes, with certain modifications. For taxable years beginning after December 31, 1992, and before January 1, 1994, the Internal Revenue Code means the Code as amended to December 31, 1992, except that most changes made by the Omnibus Budget Reconciliation Act of 1993 (Public Law 103-66) apply for Wisconsin purposes at the same time as for federal purposes. For taxable years beginning after December 31, 1993, the Code as amended to December 31, 1993, applies. Sections 71.22(4)(h) and (i) and (4m)(f) and (g), 71.26(2)(b)8 and 9, 71.34(1g)(h) and (i), and 71.42(2)(g) and (h), Wis. Stats., as affected by 1993 Wisconsin Acts 16 and 437.

**Question 2:** Does the dollar limitation of controlled groups of corporations in IRC sec. 179(d)(6) apply for Wisconsin franchise and income tax purposes?

**Answer 2:** Yes. Members of a controlled group of corporations are treated as one taxpayer in applying the dollar limitation for Wisconsin purposes. The limitation applies even though Wisconsin does not allow the filing of consolidated returns. The dollar limitation for members of controlled groups applies since it is contained in IRC sec. 179 and this Code section is not modified for Wisconsin purposes.

For Wisconsin, the section 179 expense deduction must be allocated according to an agreement made by the members of the controlled group. However, the amount of expense allocated to any group member cannot exceed the cost of the qualifying property actually purchased by the member and placed in service.

**Question 3:** Must corporations claim the same section 179 expense deduction for Wisconsin purposes as for federal purposes?

**Answer 3:** Corporations, except insurance companies, are not required to claim the same section 179 expense deduction for federal and Wisconsin purposes. A corporation which takes a federal section 179 expense deduction may elect not to claim it, or to claim a different amount to the extent allowable under IRC sec. 179, for Wisconsin purposes. A corporation may elect to claim a section 179 expense deduction for Wisconsin but not for federal purposes. A controlled group of corporations may have a different allocation of the section 179 expense deduction among its members for federal and Wisconsin purposes.

Insurance companies, however, must take the same section 179 expense deduction for Wisconsin purposes as for federal purposes. Members of a controlled group of corporations must allocate the deduction in the same manner as federally. For insurance companies, elections authorized by

and made in accordance with the Internal Revenue Code, except an election to file consolidated returns or to claim a credit against federal tax liability rather than a deduction from income, are deemed elections for Wisconsin purposes. Sec. 71.49(2), Wis. Stats. (1991-92).

**Question 4:** How does a corporation, other than an insurance company, elect a different section 179 expense deduction for Wisconsin purposes?

**Answer 4:** A corporation elects a different Wisconsin section 179 expense deduction by completing a federal Form 4562, Depreciation and Amortization, in accordance with the Wisconsin election. Form 4562 must be attached to the corporation's original Wisconsin franchise or income tax return or to an amended return filed no later than the due date, including extensions, for its return for the year the property is placed in service. Once made, the election cannot be revoked without the permission of the Department of Revenue.

**Question 5:** If a corporation claimed a $17,500 section 179 expense deduction on its 1993 federal return but only $10,000 on its 1993 Wisconsin franchise or income tax return because the Wisconsin law adopting the increase to $17,500 (1993 Wisconsin Act 437, published May 9, 1994) had not been enacted by the due date of its return, may the corporation file an amended return to increase its section 179 expense deduction?

**Answer 5:** Yes. A corporation, including an insurance company, may file an amended 1993 Wisconsin return to increase its section 179 expense deduction. An insurance company must claim the same section 179 expense deduction for Wisconsin purposes as allowed on its 1993 federal return. The amended return is due within 4 years of the original due date of the 1993 Wisconsin return.□

## INDIVIDUAL INCOME AND CORPORATION FRANCHISE AND INCOME TAXES

### 7 Amortization of Intangible Assets for Wisconsin Purposes

**Statutes:** Sections 71.01(6) and (7r), 71.22(4) and (4m), 71.26(2)(b) and (3)(y), 71.34(1g), 71.365(1m), 71.42(2), and 71.45(2)(a)13, Wis. Stats. (1991-92), and as affected by 1993 Wisconsin Acts 16 and 437

**Background:** Internal Revenue Code (IRC) section 197, as added by the Omnibus Budget Reconciliation Act of 1993 (Public Law 103-66, signed August 10, 1993), allows taxpayers to claim amortization deductions with respect to a broad range of intangible assets called "amortizable section 197 intangibles." The deduction is calculated by amortizing the adjusted basis of an eligible section 197 intangible ratably over a 15-year period beginning with the month in which the intangible is acquired. No other depreciation or amortization deduction is permitted with respect to any section 197 intangible.

Section 197 intangibles include goodwill and going concern value; workforce in place; information base; know-how; customer-based intangibles; supplier-based intangibles; government licenses and permits; franchises, trademarks, and trade names; insurance policy expirations; and bank deposit base.

Assets acquired in connection with the acquisition of a business that are treated as section 197 intangibles include covenants not to compete; computer software; films, sound recordings, video tapes, and books; copyrights and patents; rights to receive tangible property or services; interests in patents and copyrights; mortgage servicing rights secured by residential real property; and contract rights good for less than 15 years or fixed in amount.

Self-created intangibles, such as goodwill created through advertising, are not amortizable under IRC section 197.

The federal treatment of section 197 intangibles applies for property acquired after August 10, 1993, or, at the taxpayer's option, to all section 197 intangibles acquired after July 25, 1991.

The Internal Revenue Service has issued temporary regulations (Treas. Reg. §1.197-1T, effective March 15, 1994) for making an election to apply IRC section 197 retroactively. The regulations provide that the retroactive election must be made by the due date, including extensions, for filing the taxpayer's federal income tax return for the taxable year that includes August 10, 1993. If the taxpayer's original federal income tax return was filed before April 14, 1994, the election may be made by amending that return no later than September 11, 1994. Once made, the election may be revoked only with the consent of the Internal Revenue Service.

**Question:** What is the Wisconsin treatment of intangible assets that qualify as "amortizable section 197 intangibles" for federal income tax purposes?

**Answer:** The Wisconsin treatment of amortizable section 197 intangibles depends on when the assets are acquired.

*a. Acquisitions in taxable years beginning in 1994 or thereafter*

Amortizable section 197 intangible assets acquired in taxable years beginning on or after January 1, 1994, must be amortized under IRC sec. 197 for Wisconsin purposes. Secs.

71.01(7r), 71.26(3)(y), 71.365(1m), and 71.45(2)(a)13, Wis. Stats. (1991-92), as affected by 1993 Wisconsin Act 437.

*b. Acquisitions after August 10, 1993, in taxable years beginning before 1994*

For Wisconsin purposes, amortizable section 197 intangible assets acquired after August 10, 1993, in taxable years beginning before January 1, 1994, are treated as follows:

- Individuals, fiduciaries, partnerships, C corporations (except as indicated below), tax-option (S) corporations, and insurance companies may elect to amortize their eligible section 197 intangibles under IRC sec. 197. For taxable years beginning in 1993, these taxpayers have the option of computing amortization under either the federal Internal Revenue Code in effect for the taxable year for which the return is filed or the Internal Revenue Code as amended to December 31, 1992. Similarly, for taxable years beginning in 1992, they may use either the amortization methods allowable for federal income tax purposes or the Internal Revenue Code as amended to December 31, 1991. Secs. 71.01(7r), 71.26(3)(y), 71.365(1m), and 71.45(2)(a)13, Wis. Stats. (1991-92), and as affected by 1993 Wisconsin Act 16.

- Exempt corporations, regulated investment companies, real estate investment trusts, and real estate mortgage investment conduits are required to amortize their eligible section 197 intangibles under IRC sec. 197, the same as for federal purposes. These taxpayers must compute their Wisconsin net income for taxable years beginning in 1993 under the December 31, 1992, Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1993. They must compute their Wisconsin net income for taxable years beginning in 1992 under the December 31, 1991, Internal Revenue Code as amended by certain federal laws enacted after 1991, including the Omnibus Budget Reconciliation Act of 1993. Secs. 71.22(4m)(f) and 71.26(2)(b)8, Wis. Stats., as affected by 1993 Wisconsin Acts 16 and 437.

*c. Acquisitions after July 25, 1991, and before August 11, 1993*

Taxpayers may retroactively elect to amortize their eligible section 197 intangibles acquired after July 25, 1991, and before August 11, 1993, for Wisconsin purposes as provided in IRC sec. 197. The federal rules in Treas. Reg. §1.197-1T for making the election also apply for Wisconsin purposes. Secs. 71.01(7r), 71.26(3)(y), 71.365(1m), and 71.45(2)(a)13, Wis. Stats. (1991-92), and secs. 71.22(4m)(d), (e), and (f) and 71.26(2)(b)6, 7, and 8, Wis. Stats., as affected by 1993 Wisconsin Acts 16 and 437.

The election must be made within the time prescribed by the federal regulations. It is made by attaching a copy of the federal election statement to the Wisconsin return filed.

A taxpayer may make different federal and Wisconsin elections with respect to eligible section 197 intangibles acquired after July 25, 1991, and before August 11, 1993. One who elects to apply the rules in IRC sec. 197 to intangibles acquired before August 11, 1993, for federal purposes is not required to make the same election for Wisconsin purposes. Alternatively, a taxpayer may elect to amortize such eligible section 197 intangibles under IRC sec. 197 for Wisconsin purposes but not for federal purposes. The requirements of Treas. Reg. §1.197-1T apply to taxpayers making the retroactive election only for Wisconsin purposes. A taxpayer who is making different elections for federal and Wisconsin purposes must attach an election statement to the Wisconsin return filed. □

## SALES AND USE TAXES

**Note:** The following tax release interprets 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 1993 issue of the *Sales and Use Tax Report*. A copy can be found in *Wisconsin Tax Bulletin* 85 (January 1994), pages 37 to 40.

### 8 Bottled Water

**Statutes:** Sections 77.54(20)(intro.) and (b) and 97.29(1)(i), Wis. Stats. (1991-92)

**Wis. Adm. Code**: Section Tax 11.51(2), December 1992 Register

**Background**: Section 77.54(20) (intro.), Wis. Stats. (1991-92), provides that gross receipts from the sale of food, food products, and beverages for human consumption are exempt from Wisconsin sales or use tax.

Section 77.54(20)(b)4, Wis. Stats. (1991-92), provides that food, food products, and beverages exempt from Wisconsin sales or use tax do not include soda water beverages as defined in sec. 97.29(1)(i), Wis. Stats.; bases, concentrates, and powders intended to be reconstituted by consumers to produce soft drinks; and fruit drinks and ades not defined as fruit juices in sec. 97.02(27), Wis. Stats. (1967-68).

Section 97.29(1)(i), Wis. Stats. (1991-92), defines "soda water beverage" as all beverages commonly known as soft drinks or soda water, whether carbonated or uncarbonated, sweetened, or flavored.

In a decision dated April 8, 1994, the Wisconsin Tax Appeals Commission held in the case of *Artesian Water Company, Inc. vs. Wisconsin Department of Revenue* that bottled artesian spring water was a beverage and, therefore, the sale of the bottled artesian spring water was exempt from Wisconsin sales or use tax under sec. 77.54(20)(intro.), Wis. Stats. (1991-92). The department filed a notice of nonacquiescence with respect to this decision dated May 31, 1994.

**Question:** Is the sale of bottled water exempt from Wisconsin sales or use tax?

**Answer:** The sale of bottled water for human consumption that is not carbonated and is not sweetened or flavored is exempt from Wisconsin sales or use tax. However, bottled water that is carbonated and/or sweetened or flavored is not exempt from Wisconsin sales or use tax because such water is a "soda water beverage" specifically excluded from exemption. (sec. 77.54(20)(intro.) and (b)4, Wis. Stats. (1991-92)).

The size of the container in which the bottled water is sold is not a factor in determining whether the sale of bottled water is exempt from Wisconsin sales or use tax.

**Caution:** The following examples of bottled water reflect products and their content as of May 31, 1994. If the contents of the products listed were to change, the tax treatment may also change.

Examples of bottled water which are not subject to Wisconsin sales or use tax include (this list is not all-inclusive):

- Artesian Wells Natural Spring Water
- Buffalo Don Distilled Water
- Century Spring Water
- Chippewa Nonsparkling Spring Water
- Crystal Geyser Natural Alpine Spring Water
- Culligan Natural Spring Water
- Evian Natural Spring Water
- Grayson Pure Mountain Water
- Klarbrunn Drinking Water
- LaCrosse Premium Water
- Longbring Pure & Natural Spring Water
- Naya Canadian Natural Spring Water
- Poland Spring Natural Spring Water
- Sedona Mountain Spring Water
- Springside Pure Artesian Drinking Water
- Thorspring Iceland Pure Spring Water
- Vivant Natural Spring Water

Examples of bottled water subject to Wisconsin sales or use tax include (this list is not all-inclusive):

- Aqua Vil Spring Water Beverage (carbonated)
- Canada Dry Sparkling Water (original and flavored)
- Canada Dry Tonic Water
- Canfield's Clear Sparkling Mineral Water
- Canfield's Seltzer Water
- Cascadia Sparkling Water With Juice
- Chippewa Sparkling Spring Water
- Clearly Canadian Sparkling Water Beverage
- Clearly Canadian Sparkling Water Refresher
- Clearly Tea Sparkling Water Refresher
- Everfresh Juice & Sparkling Mineral Water
- Gold Medal Sparkling Mineral Water
- Hansens Natural Soda
- Klarbrunn Sparkling Water (natural and flavored)
- Koala Sparkling Fruit Juice Beverage
- Koala Sparkling Mineral Water & Fruit Juice
- LaCroix Sparkling Mineral Water (flavored and non-flavored)
- Mendota Springs Sparkling Mineral Water (natural and flavored)
- Mistic Flavored Fruit Beverage With Sparkling Water & Juice
- Original New York Seltzer Sparkling Water
- Perrier Sparkling Mineral Water (flavored and non-flavored)
- Quest Sparkling Spring Water
- Schweppes Seltzer Water
- Schweppes Tonic Water
- West End All Natural Soda Brew

**Note:** The sales and use tax treatment of bottled water in this tax release supersedes the treatment of bottled water as described in sec. Tax 11.51(2)(a), Wis. Adm. Code, December 1992 Register. Section Tax 11.51(2)(a), Wis. Adm. Code, December 1992 Register, will be revised to reflect the above treatment.

As stated in the introduction of the tax release section of this Bulletin, this tax release applies retroactively and prospectively to all periods open to adjustment. □

# 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:



**W9419002,** February 11, 1994

**Type Tax:** Individual Income

**Issue:** Capital gains — sale of small business stock

**Statutes:** Sections 71.01(10) and 71.05(6)(b)6, Wis. Stats. (1991-92)

This letter responds to your request for a private letter ruling regarding the capital gains exclusion for small business stock.

**Facts**

Taxpayer A and Taxpayer B (the "Shareholders") are the only shareholders of XYZ Corporation (XYZ), a Delaware corporation that has its principal place of business in Wisconsin.

XYZ wishes to change its state of incorporation from Delaware to Wisconsin. To accomplish this, a new Wisconsin corporation will be created (the "Wisconsin Corporation"), with the Shareholders as the only shareholders. The Shareholders will be issued stock in the Wisconsin Corporation in the same proportion as their ownership of XYZ in exchange for their agreement to vote to merge XYZ into the Wisconsin Corporation. XYZ will then merge into the Wisconsin Corporation, with the Wisconsin Corporation as the surviving entity. Upon completion of the merger, the Shareholders will own the Wisconsin Corporation in the same proportions as they currently own XYZ. The Shareholders intend that this transaction qualify as a tax-free reorganization under section 368(a)(1)(F) of the Internal Revenue Code. XYZ is a tax-option corporation under Wisconsin law, and the Wisconsin Corporation will be a tax-option corporation.

XYZ wishes to change its state of incorporation from Delaware to Wisconsin because this state is the primary location of its operations and the recent amendments to Wisconsin's corporate code have eliminated most of the reasons that favored incorporation in Delaware. This change will also simplify XYZ's recordkeeping and other administrative matters and will eliminate the need to pay fees and taxes to Delaware as well as Wisconsin.

Both Taxpayer A and Taxpayer B currently own shares of XYZ common stock. You have stated that 96.7% of Taxpayer A's stock shares and 96.7% of Taxpayer B's stock shares were issued in 1991 (the "Issue Date"), and are eligible to be "small business stock," as that term is defined by sec. 71.01(10), Wis. Stats., if the Shareholders hold those shares for the required five years. If they do so, those shares will be eligible for the small business stock capital gains exclusion stated in sec. 71.05(6)(b)6, Wis. Stats. (the "Exclusion"), as that section read prior to its amendment by 1991 Wisconsin Act 39.

**Request**

Assuming that the Shareholders' XYZ stock issued on the Issue Date is eligible for the Exclusion, you request a ruling that 96.7% of Taxpayer A's stock shares in the Wisconsin Corporation will be eligible for the Exclusion, if such shares meet all of the requirements of sec. 71.01(10), and 96.7% of Taxpayer

B's stock shares in the Wisconsin Corporation will be eligible for the Exclusion, if such shares meet all of the requirements of sec. 71.01(10). The five-year period that the Shareholders must hold their stock in the Wisconsin Corporation under sec. 71.01(10) begins on the Issue Date rather than on the date the Shareholders acquire the stock in the Wisconsin Corporation.

**Ruling**

None of Taxpayer A's shares in the Wisconsin Corporation and none of Taxpayer B's shares in the Wisconsin Corporation will qualify for the small business stock capital gains exclusion.

**Analysis**

For stock issued on or after August 16, 1991, sec. 71.05(6)(b)6, Wis. Stats. (1991-92), provides the following subtraction modification:

> For the original purchaser of small business stock that is purchased at the time that the business is incorporated, the amount of net capital gains on small business stock otherwise subject to the tax under s. 71.02 if the taxpayer has not acquired the stock by gift, ***has not acquired the stock in a stock-for-stock exchange*** and submits with the taxpayer's return a copy of the certification under s. 71.01(10). (Emphasis added.)

Since the Wisconsin Corporation stock will be issued after August 15, 1991, in a stock-for-stock exchange, the Exclusion does not apply to the Shareholders who receive Wisconsin Corporation stock in exchange for their previously owned XYZ stock. The Exclusion does not apply even if the original XYZ shares had qualified as small business stock under sec. 71.01(10), Wis. Stats. □

✵ **W9417001,** February 1, 1994

**Type Tax:** Sales and Use

**Issue:** Exemptions — waste reduction and recycling

**Statutes:** Section 77.54(26m), Wis. Stats. (1991-92)

This letter responds to your request for a private letter ruling regarding the Wisconsin sales and use tax treatment of the lease of a road reclaimer/stabilizer.

**Facts**

ABC Company intends to lease out, on a short-term basis, a road reclaimer/stabilizer with an operator.

Powered by a diesel engine, the 52,000 pound, 525 horsepower reclaimer features four wheel drive and four wheel steering. It has a cutter for depths up to 16 inches below grade and a stabilization rotor that can cut a 20 inch depth in sand and shale. A mixing box is centered under the machine for combining materials with asphalt or soil being reclaimed or stabilized. An automated spray system is attached and delivers additives to the surface being reclaimed for purposes of emulsion or rejuvenation of the materials.

The road reclaimer/stabilizer performs the following functions:

1. Cuts existing asphalt on roadways and grinds it so that it can be used as a base material for a new road surface.

2. Adds and mixes cement, lime, and other stabilizing agents with existing soil on roadways. The result is used as a sub-base in road building.

Without the use of the road reclaimer/stabilizer, unsuitable asphalt and soil on roadways would be removed and disposed of at dump sites.

**Request**

You ask whether the lease of the road reclaimer/stabilizer with an operator is exempt from Wisconsin sales or use tax under sec. 77.54(5)(c) or (26m), Wis. Stats. (1991-92).

**Ruling**

The lease of the road reclaimer/stabilizer with an operator is exempt from Wisconsin sales or use tax under sec. 77.54(26m), Wis. Stats. (1991-92). The lessee should provide ABC Company with a properly completed exemption certificate (Form S-207).

Note: An assumption has been made for purposes of this ruling that the lessee is responsible for the satisfactory completion of a job using the road reclaimer/stabilizer. Therefore, as stated in sec. Tax 11.29(4)(b), Wis. Adm. Code, providing the road reclaimer/stabilizer with an operator is the lease of tangible personal property rather than the performance of a service.

**Analysis**

Section 77.54(26m), Wis. Stats. (1991-92), provides an exemption from Wisconsin sales or use tax for the gross receipts from the sale of waste reduction and recycling machinery and equipment exclusively and directly used for waste reduction or recycling activities which reduce the amount of solid waste generated, reuse solid waste, recycle solid waste, compost solid waste, or recover energy from solid waste.

For purposes of this subsection, "solid waste" means garbage, refuse, sludge, or other materials or articles, whether discarded or purchased, resulting from industrial, commercial, mining or agricultural operations, or from domestic use or from public service activities.

A "sale" is defined in sec. 77.51(14)(j), Wis. Stats. (1991-92), to include the granting of possession of tangible personal property by a lessor to a lessee.

The road reclaimer/stabilizer is used exclusively and directly in waste reduction and recycling activities because the road reclaimer/stabilizer reuses the unsuitable asphalt and soil, along with other materials, as road bases in installing new road surfaces. The unsuitable asphalt and soil meet the definition of solid waste because they are materials resulting from commercial operations.

The exemption under sec. 77.54(5)(c), Wis. Stats. (1991-92), for motor vehicles used in waste reduction and recycling activities does not apply because the road reclaimer/stabilizer is not a motor vehicle. Section Tax 11.83(1), Wis. Adm. Code, provides that "motor vehicle" does not include a self-propelled vehicle which is not designed or used primarily for transportation of persons or property, and is only incidentally operated on a public highway, such as road machinery. □