



# Wisconsin TAX BULLETIN



## Tax Season Gear-Up



See articles on pages 1 to 6.

### 25 Felony Counts Former Car Dealer Charged

A former Oshkosh car dealer, William P. Doucas, 35, of Oconomowoc, was charged in August 1995 with 25 felony counts of fraud and failing to pay state sales tax. The charges filed in Winnebago County Circuit Court include five counts of failure to pay nearly \$200,000 in sales taxes and 18 counts of felony fraud for failure to pay liens on 18 cars. In addition, Doucas was charged with one count each of submitting a fraudulent loan application and failure to put more than \$12,000 in employee funds into a retirement plan account.

If convicted on all counts, Doucas faces a maximum penalty of 106 years in prison and a fine of \$250,000.

For information regarding additional criminal tax charges, see the article titled "Tax Evaders Sentenced to Jail" on page 9 of this Bulletin. ☐

### Targeted Field Audits of Lodging Providers

Field auditors recently received assignments for targeted sales and use tax field audits of the lodging industry. These assignments are a result of the recommendations of an audit team which performed 30 targeted audits as a pilot study of this industry.

A targeted field audit is more than a self-audit performed by the taxpayer, but less than a full field audit of the taxpayer's records. There is limited personal contact between the taxpayer and the auditor. The taxpayer is provided with an educational publication and an audit package of worksheets and instructions. The targeted field audit will include taxpayer education of the sales and use tax laws applicable to their industry, taxpayer compilation of audit workpapers, auditor review of the information provided on those workpapers, and the issuance of a field audit report.

These targeted field audits serve the dual purpose of educating the taxpayer and allowing the department to audit taxpayers that may not have otherwise been audited due to limited auditor resources. ☐

### Form Changes for 1995

Following are brief descriptions of the major changes to the Wisconsin individual income tax forms for 1995.

- Check boxes are added to Forms 1, 1A, WI-Z, and 1NPR, for indicating whether the taxpayer earned income from personal or professional services performed in Minnesota while a Wisconsin resident. Space is also provided for entering the amount of such income.
- Spaces are added to Forms 1, 1A, and 1NPR, for entering information on qualifying children and the amount of federal earned income credit. The Wisconsin earned income credit for 1995 is a percentage of the federal earned income credit based on the number of qualifying children.
- The line for the preparer's signature or name is removed from Forms 1, 1A, and 1NPR and Schedules H and FC. It is no longer necessary for preparers to sign or fill in their names on these forms.
- Addresses for mailing returns to the department are moved to the back of Form 1.
- The signature area of Form 1 is redesigned. The space for the spouse's signature is below the taxpayer's signature line in the bottom left corner of Form 1.
- A bar code is added to Form WI-Z and changes are made to the entry area. These changes will allow the form to be electronically scanned by the department.

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Preliminary copies of the 1995 Forms 1A, 1, and 1NPR and the homestead credit and farmland preservation credit claim forms, Schedule H and Schedule FC, are reproduced on pages 49 to 60 of this Bulletin. The copies are subject to further revision. □

## 1995 Income or Franchise Tax Changes

Following are brief descriptions of some of the Wisconsin law changes which affect individuals or corporations in completing 1995 Wisconsin income tax or franchise/income tax returns. See *Wisconsin Tax Bulletin* 93 (August 1995) for additional information about laws enacted in 1995.

### Individuals

- **Earned income credit.** The Wisconsin earned income credit is again based on a percentage of the federal earned income credit, rather than being computed separately from the federal credit. The Wisconsin credit is 4%, 16%, or 50% of the federal credit, depending on whether the person has one, two, or three or more quali-

fying children (no Wisconsin credit is allowed if there are no qualifying children). Schedule EICW is no longer necessary and has been eliminated.

- **Social security benefits.** Any difference between the amount of social security taxable for Wisconsin and federal purposes may be claimed as a subtraction modification, rather than a Schedule I adjustment as required for 1994.
- **Minnesota-Wisconsin reciprocity study.** As part of a study to determine the revenue effect of Minnesota-Wisconsin reciprocity, the individual income tax forms include spaces to provide information regarding wages or other personal service income earned in Minnesota.

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- **Medical care insurance deduction.** The Wisconsin deduction for medical care insurance costs paid by a self-employed person is increased from 50% to 100% of the costs. The deduction remains at 50% for employees whose employer does not contribute toward the cost of the insurance. (Note: This change is the result of a Wisconsin law change enacted in 1993 and is not described in *Wisconsin Tax Bulletin 93*.)
- **Standard deduction for dependents.** The minimum standard deduction for a person who can be claimed as a dependent on someone else's income tax return is increased from \$600 to \$650. Therefore, a Wisconsin income tax return must be filed by a dependent who has \$1 or more of nonwage income *and* \$650 or more of gross income. (Note: This change is the result of a Wisconsin law change enacted in 1993 and is not described in *Wisconsin Tax Bulletin 93*.)

### Corporations

- **University of Wisconsin Hospitals and Clinics Authority.** Income these entities receive is exempt from corporation franchise and income tax.
- **State bond interest.** Interest from certain state bonds must be included in the measure of net income for corporations and insurance companies subject to the franchise tax. The bonds are WHEDA bonds for professional sports and entertainment home stadiums and local exposition district bonds.
- **Temporary recycling surcharge.** The temporary recycling surcharge does not apply to corporations, tax-option (S) corporations, or insurance companies, that have less than \$4,000 of total receipts.

### Individuals and Corporations

- **Development zones credits.** Two new development zones credits are available to individuals and corporations. One is a development zones day care credit of up to \$1,200 of employment-related day care expenses for each qualifying individual. The other is a development zones environmental remediation credit of 7.5% of expenses to remove or contain environmental pollution, or to restore soil or groundwater affected by environmental pollution. □



### Wisconsin Electronic Filing is #1

This year's Wisconsin Electronic Filing (ELF) Program was number one in the nation in increased volume, with a 36% boost in ELF returns received. Wisconsin also had:

- the fastest electronic refunds in the nation, with an average of 3 business days from receipt of the return until the refund was direct-deposited in the taxpayer's bank account, and
- an increase of 117.6% in the volume of balance due ELF returns.

The adjustment rate on electronically filed returns was less than 1%. This means that returns filed on paper were over 15 times more likely to be adjusted than electronic returns. Other benefits include acknowledgment of all returns filed electronically, increased efficiency, and reduced cost of doing business.

While Wisconsin's ELF program is growing by leaps and bounds, the department is committed to maintaining the exceptional level of customer

service that makes electronic filing the best alternative for filing your or your clients' tax returns. Service has been expanded to allow electronic filing through October 15, for returns with a filing extension.

More than 1,200 firms participated in the Wisconsin ELF Program for filing 1994 returns. To join the Wisconsin ELF Program, all you need to do is:

- **Sole Proprietors** — If you are authorized by the IRS to file electronically in Wisconsin, you will automatically be included in the Wisconsin ELF Program. No further action is necessary.
- **All Others** — Provide the Electronic Filing Coordinator with your firm's name, the Electronic Filing Identification Number (EFIN) assigned to you by the IRS, and a listing of your officers'/partners' names, addresses, and social security numbers. This information may be faxed to (608) 264-6884 or mailed to:

Wisconsin Electronic Filing  
P.O. Box 8977  
Madison, WI 53708-8977.

If you have any questions about the Wisconsin ELF Program, call the Electronic Filing Coordinator at (608) 264-6886. The ELF Program staff are looking forward to working with you in filing 1995 returns. □

### Tax Professionals Contribute to Success of Electronic Filing

The Electronic Filing (ELF) staff wants to thank those tax professionals who have participated in the Wisconsin ELF Program. The success of this program is directly related to your efforts, cooperation, and commitment

to ELF. Together, we're making Wisconsin ELF a program we can all be proud of (see the preceding article).

The Department of Revenue recently filmed a video of ELF to tell people the benefits of filing returns electronically, based on the experience of others who are already participating in the ELF Program. The department extends special thanks to Fred Goetz, Edna Kratochvil, and Marshall Mennenga for volunteering to participate in filming the video. □

## Magnetic Media Filing Required for Some Forms

Employers and payors may be required to file wage statements and information returns on magnetic media with the Wisconsin Department of Revenue. Wisconsin magnetic media filing is required if comparable wage statements or information returns are required to be filed on magnetic media with the Internal Revenue Service or Social Security Administration, the income on the form is required to be reported to Wisconsin, the number of any one type of form required to be filed with Wisconsin is 250 or more, the Combined Federal/State Filing Program is not being used, and no waiver has been granted by the department.

Wisconsin Publication 509, *"Filing Wage Statements and Information Returns on Magnetic Media,"* describes more fully what forms must be filed on magnetic media for Wisconsin, the magnetic media requirements, and when and where to file on magnetic media. If you wish to order Publication 509, you may do so by writing to Wisconsin Department of Revenue, Forms Request Office, P.O. Box 8903, Madison, WI 53708-8903, or by phoning (608) 266-1961 in Madison. □



## Use of Postcard Expanding

The Department of Revenue is expanding its use of postcards for 1995. Approximately 1 million taxpayers will receive a postcard containing a removable name and address label, rather than a booklet of 1995 forms and instructions. These are individuals who used a paid preparer to file their 1994 return. These same individuals are included in the Internal Revenue Service's postcard program.

Instructions advise taxpayers to take the postcard to their tax preparer so the preparer can transfer the mailing label to the tax return filed. For taxpayers who still want a tax booklet, the postcard will include a detachable order blank which can be completed and mailed to the department to request a booklet.

Postcards were first used by the Department of Revenue in December 1993, when 257,000 were substituted for 1993 tax booklets. The program was well received by taxpayers and, as a result, expanded for 1994 when 622,000 postcards were sent. □

## Guidelines for Substitute Tax Forms

Tax returns may generally be filed on forms that have been reproduced or on substitute forms that have been approved by the department. However, certain guidelines must be followed to ensure that the reproduced or substitute forms are compatible with the department's processing system and present information in a uniform manner.

A copy of the "Guidelines for Reproduced and Substitute Tax Forms" appears on pages 61 and 62 of this Bulletin. □

## IRS 1995 Mileage Rates Apply for Wisconsin

The 1995 optional standard mileage rates specified by the Internal Revenue Service (IRS) for computing automobile expenses for business, charitable, medical, and moving expense purposes also apply for Wisconsin.

For 1995 the IRS increased the business standard mileage rate from 29¢ per mile to 30¢ per mile for all business miles driven. The 30¢ per mile rate is allowed without regard to whether the automobile was previously considered fully depreciated.

If the standard mileage rate of 30¢ per mile is used, depreciation is considered to be allowed at 12¢ per mile for 1995, the same rate as for 1994. However, no portion of the 30¢ per mile rate is considered to be depreciation after the adjusted basis of the automobile reaches zero.

For 1995 the mileage rate allowed for calculating automobile expenses for charitable deduction purposes remains at 12¢ per mile, and the rate allowed for medical expense deductions and moving expense deductions remains at 9¢ per mile. These are the same rates that were allowed for 1994. □

## 1995 Package WI-X Will Be Available

The 1995 edition of Wisconsin's Package WI-X will be available by January 31, 1996. The Package WI-X will contain actual size copies of most 1995 Wisconsin individual and fiduciary income tax, corporation franchise and income tax, partnership, estate tax, motor vehicle fuel tax, sales and use tax, and withholding tax forms.

The cost of the 1995 Package WI-X is \$7.00 per copy. It may be ordered

on the bulk order blank (Form P-744). The bulk order blank is being mailed in October. See the following article for more information on bulk orders.

If you do not receive an order blank and you wish to purchase copies of 1995 Package WI-X, mail your request indicating the number of copies, along with the amount due, to Wisconsin Department of Revenue, Forms Request Office, P.O. Box 8903, Madison, WI 53708-8903. ☐

### Tax Form Order Blanks Mailed

During October, the department is mailing order blanks (Form P-744) to 9,000 tax preparers. Use these original order blanks (not copies) to request bulk orders of 1995 Wisconsin tax forms.

Some of the forms you order will be accompanied by additional information. For example, your order will include instructions for the forms you request; Schedules 2K-1 and 2 WD will be included with fiduciary Form 2 orders; and Schedules 3K-1 will be included with partnership Form 3 orders.

The department is also mailing order blanks (Forms P-744b and P-744L) to banks, post offices, and libraries for their use in requesting bulk orders of 1995 Wisconsin income tax forms. No charge is made for forms used for distribution to the general public (for example, in a bank, library, or post office).

If you do not receive an order blank by October 31, 1995, you may request one by contacting any department office; by writing to Wisconsin Department of Revenue, Forms Request Office, P.O. Box 8903, Madison, WI 53708-8903; or by calling (608) 267-2025.

You should place your order as early as possible after receiving the order blank. Orders are expected to be filled in late December and early January.

Package WI-X will be mailed separately in late January. Most forms in Package WI-X may be reproduced. ☐

### New Sales and Use Tax Laws Explained

The Wisconsin Legislature enacted many changes to Wisconsin tax laws in 1995, as described in *Wisconsin Tax Bulletin* 93, dated August 1995. The September *Sales and Use Tax Report* gives further explanations of the major changes to the sales and use tax laws. See pages 63 and 64 of this Bulletin for a copy of the Report, which was sent in September to all active sales and use tax registrants. ☐

### Wisconsin Tax Bulletin Annual Index Available

Once each year the *Wisconsin Tax Bulletin* includes an index of materials that have appeared in past Bulletins. The latest index available appears in *Wisconsin Tax Bulletin* 92 (July 1995), pages 35 to 61, and includes information for issues 1 (October 1976) to 90 (January 1995). ☐

### Tax Publications Available

The Department of Revenue publishes over 40 publications that are available, free of charge, to taxpayers or practitioners. To order any of the publications, write or call Wisconsin Department of Revenue, Forms Request Office, P.O. Box 8903, Madison, WI 53708-8903 (telephone (608) 266-1961).

Number	Title of Publication (and last revision date)
102	Wisconsin Tax Treatment of Tax-Option (S) Corporations and Their Shareholders (12/94)
103	Reporting Capital Gains and Losses for Wisconsin by Individuals, Estates, Trusts (10/95)
104	Wisconsin Taxation of Military Personnel (8/95)
109	Tax Information for Married Persons Filing Separate Returns and Persons Divorced in 1995 (10/95)
111	How to Get a Private Letter Ruling From the Wisconsin Department of Revenue (3/94)
112	Wisconsin Estimated Tax and Estimated Surcharge for Individual, Estates, Trusts, Corporations, Partnerships (8/94)
113	Federal and Wisconsin Income Tax Reporting Under the Marital Property Act (10/95)
114	Wisconsin Taxpayer Bill of Rights (8/95)
115	Wisconsin Federal/State Electronic Filing Handbook (9/95)
116	Income Tax Payments Are Due Throughout the Year (12/91)
117	Guide to Wisconsin Information Returns (6/95)
118	Electronic Funds Transfer Guide (12/94)
119	Limited Liability Companies (LLCs) (1/95)

120	Net Operating Losses for Individuals, Estates, and Trusts (11/94)	410	Local Exposition Taxes (11/94)
200	Sales and Use Tax Information for Electrical Contractors (7/94)	500	Tax Guide for Wisconsin Political Organizations and Candidates (9/95)
201	Wisconsin State and County Sales and Use Tax Information (9/95)	501	Field Audit of Wisconsin Tax Returns (12/92)
202	Sales and Use Tax Information for Motor Vehicle Sales, Leases, and Repairs (7/94)	502	Directory of Free Publications (12/94)
203	Sales and Use Tax Information for Manufacturers (12/94)	503	Wisconsin Farmland Preservation Credit (12/94)
205	Do You Owe Wisconsin Use Tax? (Individuals) (5/94)	504	Directory for Wisconsin Department of Revenue (12/94)
206	Sales Tax Exemption for Nonprofit Organizations (9/90)	505	Taxpayers' Appeal Rights of Office Audit Adjustments (6/92)
207	Sales and Use Tax Information for Contractors (7/94)	506	Taxpayers' Appeal Rights of Field Audit Adjustments (5/95)
210	Sales and Use Tax Treatment of Landscaping (5/94)	507	How to Appeal to the Tax Appeals Commission (8/92)
211	Sales and Use Tax Information for Cemetery Monument Dealers (10/91)	508	Wisconsin Tax Requirements Relating to Nonresident Entertainers (8/94)
212	Businesses: Don't Forget About Use Tax (7/94)	509	Filing Wage Statements and Information Returns on Magnetic Media (3/94)
213	Travelers: Don't Forget About Use Tax (3/94)	600	Wisconsin Taxation of Lottery Winnings (11/93)
214	Do You Owe Wisconsin Use Tax? (Businesses) (9/93)	601	Wisconsin Taxation of Pari-Mutuel Wager Winnings (3/94)
216	Filing Claims for Refund of Sales or Use Tax (9/95)	700	Speakers Bureau presenting ... (2/93)
400	Wisconsin's Temporary Recycling Surcharge (12/94)	W-166	Wisconsin Employer's Withholding Tax Guide (9/90) <input type="checkbox"/>

## Information or Inquiries?

Listed below are telephone numbers to call if you wish to contact the Department of Revenue about any of the taxes administered by the Income, Sales, and Excise Tax Division.

### Madison — Main Office

Area Code (608)

Appeals . . . . .	266-0185
Audit of Returns: Corporation, Individual, Homestead . . . . .	266-2772
Beverage . . . . .	266-6701
Cigarette, Tobacco Products . . . . .	266-8970
Copies of Returns: Homestead . . . . .	266-2890
Individual . . . . .	266-1266
All Others . . . . .	266-0678
Corporation Franchise and Income . . . . .	266-1143
Delinquent Taxes . . . . .	266-7879
Estimated Taxes . . . . .	266-9940
Fiduciary, Estate . . . . .	266-2772
Forms Request: Taxpayers . . . . .	266-1961
Practitioners . . . . .	267-2025
Homestead Credit . . . . .	266-8641
Individual Income . . . . .	266-2486
Motor Vehicle Fuel . . . . .	266-3223
Refunds . . . . .	266-8100
Sales, Use, Withholding . . . . .	266-2776
TDD . . . . .	267-1049

### District Offices

Appleton . . . . .	(414) 832-2727
Eau Claire . . . . .	(715) 836-2811
Milwaukee:	
General . . . . .	(414) 227-4000
Refunds . . . . .	(414) 227-4907
TDD . . . . .	(414) 227-4147



## Topical and Court Case Index Available

Are you looking for an easy way to locate reference material to research a Wisconsin tax question? The *Wisconsin Topical and Court Case Index* will help you find reference material

to research 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, subscribe to the *Wisconsin Topical and Court Case Index*. The annual cost is \$18, plus sales tax. The \$18 fee includes a volume published in December, and an addendum published in May.

To order your copy, complete the order blank on page 65 of this Bulletin. The order blank may also be used for subscribing to the *Wisconsin Tax Bulletin* and for ordering the Wisconsin Administrative Code. □



## Need a Speaker?

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

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

## Manufacturing Property Assessment

*Note: This article was prepared by the Bureau of Manufacturing Assessment in the Division of State and Local Finance of the Wisconsin Department of Revenue.*

In February, a Division of State and Local Finance reorganization eliminated the Bureau of Property Tax and upgraded the Manufacturing Assessment and Equalization Sections to Bureaus, and the Assessment Practices Section to the Office of Assessment Practices.

The Bureau of Manufacturing Assessment announces the following changes for the 1996 manufacturing self-reporting forms:

- Revision of the map of districts to reflect the shift of Grant County from the Madison District Office (AA76) to the Eau Claire District Office (AA79). Grant County manufacturers must send their forms to the Eau Claire District Office.

- Revision of Schedule M for taxable machinery and equipment (M&E) in the Personal Property Report Form (M-P) to have preprinted 10-year useful life factors. Since taxable M&E is similar for all manufacturers, the 10-year life is more accurate than using various lives according to industry. Revision of Schedule M includes creation of a separate Schedule N for boilers using a 20-year useful life.
- Revision of Schedule C to limit it to computers and software using modified 4-year useful life factors that go down to a 3% residual over 9 years. Revision of Schedule C includes creation of a separate Schedule D for copiers, fax machines, telephone systems, and equipment using the standard 6-year useful life factors.
- Creation of a microcomputer version of the M-P form using Lotus for Windows. Accountants suggested this to eliminate the need to reenter the same data every year. A signed copy of the printed output from this program is considered an acceptable facsimile of the M-P form. A diskette is not acceptable for filing purposes.

Please contact the Bureau of Manufacturing Assessment at the following address or telephone numbers, if you have any questions on the above described changes or wish to order a copy of the M-P form diskette.

Bureau of Manufacturing Assessment  
Wisconsin Department of Revenue  
PO Box 8933  
Madison, WI 53708  
Phone (608) 266-8606  
FAX (608) 264-6897 □

## Question and Answer

**Q** I received a lump-sum distribution from my former employer's retirement plan. I qualify to compute my federal income tax on this distribution using 5-year or 10-year averaging on federal Form 4972. May I also use 5-year or 10-year averaging to compute the Wisconsin income tax on the lump-sum distribution?

**A** No, you may not use 5-year or 10-year averaging to compute your Wisconsin income tax on the lump-sum distribution. Wisconsin law does not provide for 5-year or 10-year averaging. You must include the entire taxable amount of the lump-sum distribution in your Wisconsin taxable income (use Schedule 1 on the back of Form 1).

**Q** The Form 1099-R I received for a lump-sum distribution from my employer's retirement plan shows that a portion of the taxable amount of the

distribution is due to capital gains. I will file federal Form 4972 and separately compute the tax on the capital gain portion on that form. Does the capital gain portion of the lump-sum distribution qualify for the Wisconsin 60% long-term capital gain exclusion?

**A** No. The capital gain portion of a lump-sum distribution does not qualify for the Wisconsin capital gain exclusion. Both the capital gain portion and the ordinary income portion (less any allowable death benefit exclusion) of the lump-sum distribution must be included in your Wisconsin taxable income (use Schedule 1 on the back of Form 1).

**Q** Is the service of snow removal subject to Wisconsin sales tax?

**A** No.

**Q** I sell firewood in Wisconsin. Is the sale of firewood subject to Wisconsin sales tax?

**A** Generally, sales of firewood in Wisconsin are taxable. An exemption is provided, however, for wood used for fuel sold for residential use. Residential use means use in a structure, or portion of a structure, which is a person's permanent residence.

You are not required to obtain an exemption certificate from a customer if 100% of the firewood sold to the customer is used as fuel for residential use and if you maintain adequate records to identify the sales that are exempt.

If the firewood sold to a customer is only partially exempt, you must obtain a properly completed exemption certificate, Form S-017, from your customer, to substantiate the exemption. ☐

## Department of Revenue Recognized for Innovation

The Wisconsin Department of Revenue has been recognized by the Council of State Governments for two innovative programs: the delinquent tax collection fee and the motor vehicle fuel tax program. The Council received 230 nominations nationwide for their Innovations Award Program. Both department programs placed in the top 10 programs in the midwest region and the top 40 programs nationwide.

The Council of State Governments sponsors the Innovations Awards

Program to bring greater visibility to exemplary state programs and policies, and to facilitate transfer of successful programs to other states. The Innovations Awards Program is the only program in the nation that focuses exclusively on state programs and policies, and that selects winners based on evaluations by state government officials.

The delinquent tax collection fee was created in 1992 to fund the costs of the delinquent state tax collection program, and to cover start-up costs for the development of a new delinquent tax collection computer system and computer equipment for collection employees. This program origi-

nated in Wisconsin and has since been adopted in other states.

The motor vehicle fuel tax program involves a new motor vehicle fuel tax law which became effective April 1, 1994. The new law resulted from a cooperative effort between representatives of the motor fuel industry, legislators, and the Wisconsin Departments of Revenue and Transportation. Since the new law was enacted, the Department of Revenue has implemented new computer systems for a quick refund program, electronic filing, and electronic funds transfer. The department is now working on an automated program for tracking of fuel shipments. ☐



## Tax Evaders Sentenced to Jail

Trevor resident Richard J. Kamin Sr., 57, was ordered to jail in September 1995, for criminal violations of state income tax laws. Kenosha County Circuit Court Judge Barbara Kluka placed Kamin on three years probation and sentenced him to thirty days in jail, with Huber privileges.

Kamin pled guilty to two counts of failure to file Wisconsin income tax returns for 1991 and 1992. During those years he had received wages of \$47,810 and \$23,560, respectively. He had not filed an income tax return since 1974. Kamin paid \$30,000 in restitution to the department for back taxes, interest, and penalties, and he was ordered to file all back returns and keep current on his filing and payment requirements.

In June 1995, Racine businessman John R. Balestrieri, 37, was sentenced to jail for felony theft of state sales taxes, after he collected but failed to remit nearly \$12,000 in state sales taxes between January 1992 and March 1994. Racine County Circuit Court Judge Wayne J. Marik ordered Balestrieri to serve four months in jail but suspended all but two weeks of the term. He also placed Balestrieri on three years probation, ordered him to pay about \$30,000 in restitution to the Department of Revenue, and ordered him to keep current on all his other tax filing and payment requirements. If these terms are violated he could still face up to two years in prison and up to \$10,000 in fines.

Also in June, Milwaukee restaurant owner Thomas B. Shepard, 50, was charged with failure to file Wisconsin income tax returns for 1991 to 1993, when he had gross income of over \$3,000,000. The criminal complaint

states that he has not filed state tax returns for 15 consecutive years.

If convicted on all charges, Shepard could be imprisoned for up to 27 months and fined up to \$30,000.

In July 1995, the probation of La Crosse dentist Frederick Kriemelmeyer was revoked by La Crosse County Circuit Court Judge Dennis Montabon, and Kriemelmeyer was jailed without work release privileges. He violated the terms of his probation when he recently filed improper state tax returns. They were rejected by the Department of Revenue because the tax liability was not calculated and the returns failed to provide sufficient information.

**"There's no good reason to allow you to continue earning money if you refuse to pay taxes."**

— Judge Dennis Montabon

Kriemelmeyer was convicted in the fall of 1994 of three counts of failing to file state income tax returns and was sentenced to 27 months in jail. He was placed on three years' probation, and 18 months of the jail term were suspended. He began serving the remaining jail term in April 1995 with work release privileges, but the order revoking probation also revoked the work release and reinstated the balance of the 27-month jail term.

Also in July, Grafton accountant Dan Davis and his wife, Jan H. Thiermann-Davis, were charged by the Ozaukee County District

Attorney's Office with two counts each of failure to file Wisconsin income tax returns. Dan Davis was also charged with two counts of failure to remit withholding taxes that he had withheld from an employee's wages.

According to the complaint, the Davises failed to file income tax returns for 1992 and 1993, when their combined gross incomes were \$119,382 and \$95,720, respectively. If convicted on all counts, Dan Davis faces up to three years in jail and up to \$40,000 in fines, and Jan Davis faces up to 18 months in jail and \$20,000 in fines.

In August 1995, Onalaska chiropractor Don Loeffler, 43, pled guilty in La Crosse County Circuit Court to two misdemeanor counts of failing to file state tax returns for 1992 and 1993. A third count for failing to file in 1991 was dismissed but considered at sentencing.

Judge John Perlich ordered a four-month jail term and three years probation. The jail time will include work release privileges as long as Loeffler meets the conditions of his probation, under which he is to: disclose all of his personal assets and income; file state and federal tax returns and pay all taxes, penalties, and interest owed for 1991 to 1993; pay all costs associated with the investigation and audit of his tax situation; and file timely state and federal tax returns during his probation.

Former Oshkosh car dealer William P. Doucas was charged in August 1995, with 25 counts of fraud and failure to pay sales tax. See the article on page 1 of this Bulletin for further details. □

## PartnerCare Enrollment Cards Mailed

In October 1995, the department is mailing PartnerCare enrollment cards and an explanatory flyer to approximately 16,000 individuals. The mailing is based on a listing of 1994 homestead credit claimants and their spouses age 65 or older, whose household income for 1994 did not exceed \$19,154, and who were not mailed a PartnerCare card by the department in 1992, 1993, or 1994.

PartnerCare is a program sponsored by the State Medical Society of Wisconsin and the Coalition of Wisconsin Aging Groups. Its purpose is to help low-income senior citizens get the medical care they need. Participating doctors volunteer to charge PartnerCare cardholders no more than the amount Medicare approves, for Medicare-covered services.

Prior to 1992, PartnerCare cards mailed by the department were temporary or "annual" cards, with an expiration date (the cards mailed in October 1991, for example, expired December 31, 1992). The cards mailed out beginning October 1992, however, are "permanent" cards, with no expiration date. Individuals are no longer issued a new card each year; those who were mailed a permanent card in October 1992, 1993, or 1994 will not receive one this year.

To enable more eligible persons to receive a PartnerCare card, the homestead credit claim, Schedule H, includes a check box near the box for the claimant's age. By checking the box if the claimant has a spouse age 65 or older, the department is able to issue a PartnerCare card to the spouse if applicable, as well as to the claimant. ☐

## Over 1.8 Million Refunds Issued

Taxpayers were issued more than 1.8 million income tax refunds during January through July 1995 (primarily 1994 returns), for an average refund of \$327. The average refund for 1993 returns was \$320.

There were 2,608,000 Wisconsin individual income tax returns filed during the twelve months ending June 30, 1995. This compares to 2,593,000 returns for the prior year. The 2,608,000 returns, which included joint tax returns, were filed by 3,731,000 individuals.

An itemized deduction credit was claimed by 27% of the taxpayers on their 1994 returns. The average credit was \$360, compared to \$343 on 1993 returns.

There were 222,000 homestead credit claims filed during the year, and the average credit was \$456. This compares to 235,000 homestead credit claims averaging \$457 for the prior year. About 50% of the claimants were age 65 or older, 47% were renters, and 53% were homeowners.

About 25,500 farmland preservation credit claims, averaging \$1,288 per claim, were filed during the year ending June 30, 1995. During the prior year 24,300 farmland preservation credit claims were filed, and the average payment was \$1,240. ☐

## Taxpayers Designate \$315,133 to State Election Campaign Fund

Wisconsin income tax returns, Forms WI-Z, 1A, 1, and 1NPR, include a box for taxpayers to designate \$1 to the State Election Campaign Fund. Checking the election box does not increase the tax liability or reduce a taxpayer's refund.

During July 1994 to June 1995 (primarily 1994 tax returns), taxpayers designated \$315,133 to the election campaign fund on their Wisconsin tax returns. This compares to \$359,662 for the prior year. ☐

## Endangered Resources Contributions Total \$600,000



The 1994 Wisconsin income tax returns, Forms WI-Z, 1A, 1, and 1NPR, included a line for taxpayers to designate a contribution to the Wisconsin Endangered Resources Fund. These donations either reduce a taxpayer's income tax refund or increase the amount of income tax owed. Amounts contributed go to the Wisconsin Department of Natural Resources to help protect and care for Wisconsin's endangered species, nongame wildlife, and rare plant and animal habitats.

Donations to the Endangered Resources Fund can be made on both paper filed tax returns and electronically filed returns.

During July 1994 through June 1995 (primarily 1994 returns), 50,585 taxpayers contributed \$599,760 to the Endangered Resources Fund. This compares with 1993 income tax returns, where 54,052 taxpayers contributed \$614,000. ☐

## Connecticut Offers Tax Amnesty

*Note: Information for this article was submitted by Gene Gavin, Commissioner, Connecticut Department of Revenue Services.*

Between September 1 and November 30, 1995, Connecticut is making an attractive offer to those who owe back taxes to Connecticut: Come forward and pay the tax and interest you owe under the Connecticut Tax Amnesty Program, and avoid penalties and possible criminal prosecution.

Some taxpayers may also be eligible for a reduced interest rate.

### Eligibility

The program applies to all taxes administered by the Connecticut Department of Revenue Services (DRS) including business taxes and individual taxes. Only taxes owed for periods ending on or before March 31, 1995 are eligible for Amnesty. Taxpayers will not be granted Amnesty if they are under audit or criminal investigation by the DRS or if they are involved in any criminal or civil litigation with the DRS.

Because Connecticut enacted a personal income tax in 1991, DRS expects that many nonresidents may have been unaware of their potential liability. Former residents who have moved out of Connecticut since 1991 may owe back taxes. Likewise, nonresidents who earned Connecticut source income, including income from the sale or rental of property located in Connecticut or income from work performed in Connecticut, may be liable for tax on the income.

### Applications

To receive an application for participating in the Amnesty Program, call DRS at (203) 566-7033 24-hours a day. You may also speak to a Taxpayer Services representative between 8:30 a.m. and 4:30 p.m., Eastern time. Application forms are also available on DRS's fax retrieval system, DRS TAX-FAX, by calling (203) 297-5698 24-hours a day. □

## TCMP: An Effective Tool For Increasing Voluntary Compliance

*Note: This article was submitted by John T. Ader, Director, Milwaukee District, Internal Revenue Service.*

Each week Americans don't pay over \$2 billion in federal income taxes they owe. Over a year's time, that's

a lot of money — enough to halve the deficit or fund important government programs.

Over the past 20 years, United States taxpayers have voluntarily paid approximately 83 percent of the tax dollars they owe. Our enforcement efforts bring in another three to four percent each year, making our total annual collection approximately 86 percent of federal taxes due.

As tax administrators, our mission is to collect the proper amount of tax at the least cost and ensure that our tax laws are fairly enforced.

We have set a short-term goal to collect 90 percent of the tax due by increasing voluntary compliance and enforcement. However, like all federal agencies in these lean-budget times, we have a finite number of resources to apply to this goal.

To improve voluntary compliance, we need to know where the problems are. For over 30 years, the Taxpayer Compliance Measurement Program (TCMP) has helped identify those problems. Through TCMP, IRS obtains statistically valid information on compliance behavior. That information allows us to focus our limited resources on the most productive and least compliant tax returns.

TCMP uses random sampling to select and examine tax returns to learn how correctly taxpayers are reporting and paying their federal income tax. In the proposed TCMP, we would audit approximately 153,000 tax returns nationwide — about 2,900 in Wisconsin.

The information from TCMP helps the IRS in many ways.

- It helps us update the formulas we use to select returns for routine audits. We are then better able to focus our routine audits toward areas of noncompliance.

- It helps us identify compliance problems that can be corrected through changes to the tax code.
- It helps us allocate our resources to those areas demonstrating the lowest compliance with the tax laws.
- It helps us estimate the tax gap — taxes owed versus taxes paid.

Past TCMPs have helped us improve compliance dramatically. For example, an earlier TCMP showed that Americans often lowered their taxes by listing non-existent dependents on their tax returns. Congress changed the rules to require social security numbers for all children claimed as exemptions on returns. The next year, over seven million children "disappeared" from tax returns. In tax year 1987 alone, tax receipts jumped by nearly \$3 billion.

Another TCMP success story began when taxpayers claiming the child care credit were required by The Family Support Act of 1988 to include the care provider's name, address, and social security number. The result? Credits claimed decreased 31 percent. Schedule Cs reporting income from providing child care increased almost 65 percent. The decreased credits added more than \$1.2 billion in tax on 1989 returns. The increased Schedule Cs produced about \$343 million in additional income and self-employment taxes.

The last TCMP was conducted in 1988. That means that the data we're now using for selecting cases for routine audits, assigning resources, and estimating compliance levels is at least seven years old. In our rapidly-changing world, seven-year-old data is just not good enough.

The proposed TCMP would include tax returns of individuals, corporations, S-corporations, and partnerships. The audits would be conducted over a 30-month period.

Although the proposed TCMP would be somewhat larger, we've made some major improvements that will make life easier for all of us. Our examiners will be able to perform a much more sophisticated analysis of the sample returns through the use of two improved examination tools: "Case Building" and the "Market Segment Specialization Program (MSSP)." These tools will dramatically improve the TCMP audit process and make it possible to conduct the highest quality audits and data gathering we have ever achieved. They will allow us to increase productivity while reducing the taxpayer burden traditionally associated with TCMP audits. In other words, TCMP audits will take less time.

In past TCMPs, taxpayers were asked to provide copies of their prior and subsequent year returns for the examiner to review. Now the examiner has that information before the audit begins. "Case Building" allows the examiner to use not only the tax return in question, but also copies of three prior years' returns. Because the examiner will be better equipped and more familiar with the taxpayers' overall tax and financial situation, there will be a real time and cost savings, both for taxpayers and for the IRS.

Another major improvement in the proposed TCMP is the use of a sample that statistically represents taxpayers both by market segment and by 30 geographic areas. Past TCMPs could provide statistically valid data only by the type of return filed (e.g. Form 1040, 1120, 1065, etc.) and by reported income/asset levels.

The Market Segment Specialization Program (MSSP) is a multifaceted approach to increase compliance by using education, industry liaisons, and enforcement. Our examiners' skills are enhanced through specialized training in the unique operating procedures, issues, and tax laws

specific to particular businesses, groups, industries, and professions.

Compliance issues vary by industry and geographic area. For example, inventory issues have very different characteristics and opportunities for noncompliance in manufacturing and retail businesses. For service firms, there may be no inventory issues at all. In the past, these variances could be lost through combining statistics nationally. Now we will be able to focus our resources more effectively and consistently.

The information obtained from TCMP examinations is, of course, valuable to the IRS. But taxpayers also benefit from these examinations. Before TCMP audits began 30 years ago, almost half the returns we picked for routine audits resulted in no change. That's an incredible waste of our resources. It also caused needless frustration for many taxpayers. The information we get from TCMP helps us narrow our audit focus so that we select only those returns that need to be audited. That means that taxpayers who file accurate returns are less likely to be bothered by an unnecessary audit.

With TCMP, we are able to keep from bothering the great majority of taxpayers who report information on their returns correctly. Great progress — but we'd like to audit even fewer taxpayers who file accurate returns. TCMP can help us reach that goal. □

### 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 October 1, 1995, or at the stage in which action occurred during the period from July 1, 1995 to October 1, 1995.

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 Legislative Council Rules Clearinghouse

- |       |   |
|-------|---|
| 2.09  | Reproduction of income tax forms-R&R  |
| 2.105 | Notice by taxpayer of federal audit adjustments and amended returns-R&R   |
| 2.12  | Amended income and franchise tax returns-R&R  |
| 3.94  | Claims for refund-R   |
| 9.01  | Definitions-A   |
| 9.06  | Affixing of state revenue stamps-A  |
| 9.08  | Cigarette tax refunds to Indian tribes-A  |
| 9.09  | Cigarette sales to and by Indians on reservations of tribes that have not entered into a refund agreement with the department-A |
| 9.11  | Refunds-A   |
| 9.12  | Refunds — military-R  |
| 9.16  | Meter machines-R  |
| 9.17  | Meter machine settings-R  |
| 9.19  | Fuson machines and stamps-A   |
| 9.21  | Shipments to retailers-A  |
| 9.22  | Drop shipments-A  |
| 9.26  | Trade or transfer of unstamped cigarettes-A   |
| 9.31  | Sales out of Wisconsin-A  |
| 9.36  | Displaying of cigarettes-A  |
| 9.41  | Vending machines-A  |
| 9.46  | Purchases by the retailer-A   |

- 9.47 Invoicing of sales, including exchanges of cigarettes-A
- 9.51 Samples-A
- 9.61 Warehousing of cigarettes-A
- 9.68 Ownership and name changes-A

#### Rules Sent for Legislative Committee Review

- 2.89 Estimated tax requirements for short taxable years-NR
- 2.96 Extensions of time to file corporation franchise or income tax returns-R&R
- 3.03 Dividends received deduction — corporations-R&R

#### Rule on Hold Pending Court Decision

- 11.04 Constructing buildings for exempt entities-A

#### Rules Adopted and in Effect (adoption date July 1, 1995)

- 11.13 Direct pay-NR
- 11.14 Exemption certificates, including resale certificates-A ☐

#### Recently Adopted Rules Summarized

Summarized below is information regarding administrative rules, adopted or revised effective July 1, 1995. Included is information regarding two sales and use tax rules, secs. Tax 11.13 relating to direct pay permits, and Tax 11.14 relating to exemption certificates.

In addition to the summaries, the text of newly created sec. Tax 11.13 and recreated sec. Tax 11.14(12) is reproduced. Notes and examples appearing

in the rules are not reproduced here. See the order blank on page 65 of this Bulletin for information about obtaining the Revenue section of the Wisconsin Administrative Code.

**Tax 11.13 Direct pay.** Tax 11.13 addresses the direct pay method for reporting and paying Wisconsin sales and use taxes. Direct pay is allowed effective for taxable years beginning on or after January 1, 1995, as a result of the creation of sec. 77.52(17m), Wis. Stats., by 1993 Wisconsin Act 437. The text of Tax 11.13 is as follows:

**Tax 11.13 DIRECT PAY.** (s. 77.52(17m), Stats.) (1) DEFINITIONS. In this section:

(a) "Continuous" use of a direct pay permit means that the purchase without tax applies to the purchase being made from the retailer and subsequent purchases from that retailer and is considered a part of each order given to the retailer. The continuous use of the direct pay permit remains in force until the continuous use is voided by the direct pay permit holder.

(b) "Single purchase" use of a direct pay permit means that the purchase without tax applies only to the purchase being made from a retailer for which the direct pay permit is given.

(2) GENERAL. (a) The holder of a direct pay permit may purchase tangible personal property and taxable services, except those in sub. (6)(a) and (b), from a retailer without paying Wisconsin sales or use tax to the retailer.

(b) The direct pay permit holder shall report Wisconsin use tax on the sales price of tangible personal property or taxable services purchased from a retailer without tax using a direct pay permit if the property or service is subject to Wisconsin sales or use tax. The tax shall be reported on the direct pay permit holder's Wisconsin sales tax return for the period in which the taxable storage, use or consumption first occurs in Wisconsin.

(3) ISSUANCE. (a) The department shall issue a direct pay permit to those applicants who meet the qualifications set forth in s. 77.52(17m)(b), Stats.

(b) Persons who wish to obtain a direct pay permit shall apply to the department using the form prescribed by the department. A \$5 fee is required upon application.

(c) A direct pay permit shall be effective for purchases made beginning on the first day of the applicant's taxable year, for Wisconsin franchise or income tax purposes, after the permit is issued.

(4) REVOCATION OR CANCELLATION. (a) A direct pay permit issued by the department may be used indefinitely until it is revoked by the department or cancelled by the holder.

(b) A permit may be cancelled by the holder by mailing the permit to the department for cancellation. A letter shall be enclosed with the permit, indicating the holder's intention to cancel the permit.

(c) The cancellation of a direct pay permit shall become effective immediately following the last day of the holder's taxable year in which the permit is received by the department.

(5) USING DIRECT PAY. (a) *Documentation.* A direct pay permit holder shall provide one of the following to a retailer when purchasing without paying tax to the retailer using a direct pay permit:

1. A copy of its direct pay permit. The direct pay permit holder shall also provide to the retailer a written statement as to whether the direct pay permit is for a single purchase or is continuous.

2. A written document containing all of the following:

a. The name and address of the direct pay permit holder.

b. A statement that the direct pay permit holder is purchasing without Wisconsin sales or use tax using a direct pay permit.

c. The direct pay permit holder's direct pay permit number.

d. The effective date of the direct pay permit.

e. A statement as to whether the use of the direct pay permit is for a single purchase or is continuous.

f. The signature of the direct pay permit holder.

(b) *Continuous use.* 1. If a direct pay permit holder indicates in writing to a retailer that the use of the direct pay permit is continuous, that purchase and all subsequent purchases from the retailer, except those in sub. (6)(a) and (b), shall be made without paying Wisconsin sales or use tax to the retailer using the direct pay permit, unless the continuous use is voided by the direct pay permit holder. The direct pay permit holder may void the continuous use of its direct pay permit by furnishing the retailer a letter indicating that continuous use no longer applies.

2. If the use of a direct pay permit is continuous, it is necessary for the direct pay permit holder to provide the documentation in par. (a) to a retailer only at the time the direct pay permit holder begins making purchases without paying tax to that retailer using the direct pay permit, rather than at the time of each purchase.

3. While the use of a direct pay permit is continuous, all purchases from a retailer, except those in sub. (6)(a) and (b), shall be made using the direct pay permit even though a resale certificate, manufacturer's exemption certificate, certificate of exemption or other exemption requiring different documentation may apply.

(c) *Single purchase.* If a direct pay permit holder uses its direct pay permit for a single purchase, any subsequent purchase by the direct pay permit holder from that retailer is subject to Wisconsin sales or use tax unless the direct pay permit holder provides the information in par. (a) for that purchase or that purchase is otherwise exempt from tax.

(d) *Retailer records.* The retailer shall keep the information provided by the direct pay permit holder under par. (a) on file as authorization for the direct pay permit holder to make purchases without paying tax to the retailer.

#### (6) SERVICES AND PROPERTY NOT ELIGIBLE FOR DIRECT PAY.

(a) *Services.* A direct pay permit holder shall pay Wisconsin sales or use tax to a retailer on the retailer's sales of services to the direct pay permit holder under the following Wisconsin statutes:

1. Section 77.52(2)(a)1, Stats., relating to furnishing rooms or lodging.

2. Section 77.52(2)(a)2, Stats., relating to admissions to amusement, athletic, entertainment or recreational events, devices or facilities.

3. Section 77.52(2)(a)5, Stats., relating to telecommunications services.

4. Section 77.52(2)(a)9, Stats., relating to parking.

5. Section 77.52(2)(a)12, Stats., relating to cable television system services.

6. Section 77.52(2)(a)20, Stats., relating to landscaping services.

(b) *Property.* A direct pay permit holder shall pay Wisconsin sales or use tax to a retailer on the retailer's sale, lease or rental to the direct pay permit holder of the following tangible personal property:

1. Tangible personal property transferred to a purchaser in connection with the sale of landscaping services subject to tax under s. 77.52(2)(a)20, Stats.

2. Motor vehicles, boats, snowmobiles, mobile homes not exceeding 45 feet in length, trailers, semitrailers, all-terrain vehicles or aircraft.

3. Food, food products and beverages described in s. 77.54(20)(b), Stats.

4. Meals, food, food products and beverages subject to tax under s. 77.54(20)(c), Stats.

(c) *Exemptions.* Although not eligible to be purchased without paying Wisconsin sales or use tax to a retailer using a direct pay permit, the taxable services and tangible personal property described in pars. (a) and (b) may be purchased without Wisconsin sales or use tax if a resale, farming, manufacturing or other exemption applies. Documentation is required to purchase without tax, as provided in s. Tax 11.14.

#### (7) RETAILER'S LIABILITY — PERMIT REVOKED OR CANCELLED.

A retailer is not liable for sales or use tax on gross receipts from the sale of tangible personal property or taxable services, except those described in sub. (6)(a) and (b), to a person who has provided the retailer with the appropriate information under sub. (5)(a), until the earlier of the following:

(a) The date the retailer is notified by the direct pay permit holder or the department that the holder's direct pay permit has been revoked by the department. A direct pay permit is considered revoked on the date the holder receives the department's notice of revocation.

(b) The last day of the direct pay permit holder's taxable year in which the retailer is notified by the holder or the department that the holder's direct pay permit is being cancelled by the holder as provided in sub. (4)(b).

**Tax 11.14 Exemption certificates, including resale certificates.** Tax 11.14(2)(c) is amended to delete an obsolete statutory reference. Tax 11.14(3)(b), (3)(c), and (6)(b)4 are amended to reflect proper language and style. Tax 11.14(12) is repealed and recreated to address direct pay authorization. The text of Tax 11.14(12) is as follows:

**11.14(12) DIRECT PAY PERMITS.** The use of direct pay permits in Wisconsin is authorized under s. 77.52(17m), Stats. A person may apply to the department for a direct pay permit. □



## 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:

### Corporation Franchise and Income Taxes

Amended returns — interpretation of settlement stipulation  
*Lyndon Insurance Company*  
(p. 15)

### Sales and Use Taxes

Claims for refund — time limitation for filing  
*D & S Dental Laboratory, Inc.* (p. 17)

Computer software — tangible vs. intangible  
*Manpower International, Inc.*  
(p. 17)

### Sales Taxes and Withholding Taxes

Personal liability  
*William Drilias* (p. 18)

### Temporary Recycling Surcharge

Temporary recycling surcharge — constitutionality  
*Love, Voss & Murray* (p. 19)

## CORPORATION FRANCHISE AND INCOME TAXES

**I** Amended returns — interpretation of settlement stipulation. *Lyndon Insurance Company vs. Wisconsin Department of Revenue*

(Wisconsin Tax Appeals Commission, April 24, 1995; revised decision July 6, 1995). Following are the issues presented in this case:

- A. Whether refunds due to the taxpayer for the 1981, 1982, and 1983 taxable years to reflect certain Internal Revenue Service adjustments to federal taxable income should be calculated using the apportionment percentages disclosed in the amended returns filed by the taxpayer in May 1991, using a weighted average (60% for the taxpayer, 40% for the department) of the respective apportionment percentage positions of the parties during the first appeal, or whether the refund claims should be calculated in the manner detailed in the department's schedule supporting its July 25, 1991, notice of assessment.
- B. Whether the department applied figures correctly reflecting "Tax Previously Assessed" in the schedule accompanying its assessment notice.

The issues in this case are based upon the taxpayer's filing of original Wisconsin Insurance Franchise Tax returns for 1981, 1982, and 1983, the taxpayer's subsequent filing of amended returns corresponding to those years, and the department's issuance of an assessment notice dated December 16, 1985, in which the department recalculated the tax impact of the Internal Revenue Service adjustments reported on the amended returns.

On each of its original 1981 through 1983 Wisconsin returns, the taxpayer reported an amount of 0% for "Percent of premiums outside Wisconsin" and an amount of 100% for "Percent of payroll outside Wisconsin." The average of premiums and payroll indicated on each of the taxpayer's original 1981 through 1983 Wisconsin returns was 50%.

In a notice dated May 12, 1983, the department issued its first office audit adjustments to the taxpayer, which resulted in a net refund to the taxpayer. There were no adjustments made in the audit on the basis of error in the taxpayer's use of the 100% payroll factor, the 0% premiums factor, or the 50% average of premiums and payroll factor. There was no audit of the payroll, premiums, or average of payroll and premiums factors. The taxpayer did not appeal the department's May 12, 1983, office audit.

In a notice dated December 16, 1985, the department issued a second office audit assessment to the taxpayer for the years 1979 through 1984. In this second office audit, the department adjusted the taxpayer's previously reported payroll factor from 100% to 0% for the years 1981 through 1984, with the premiums factor remaining unadjusted at 0%.

On February 6, 1986, the taxpayer filed a petition for redetermination of the department's second office audit, objecting to specific adjustments therein and also including two general claims for refund.

The taxpayer's first general claim for refund was based on a deduction for

premium taxes and other state taxes which were omitted from its original returns for the years 1981 through 1983. These deductions were claimed as a result of adjustments made by the department in its first office audit, as set forth in the notice of refund dated May 12, 1983.

The taxpayer's second general claim for refund was based on a request that the 0% premiums factor used on its original returns for the years 1981 through 1983 be changed to include reinsurance premiums in the total premiums factor. The taxpayer did not specify the apportionment factor effect of this premiums factor change reflected in its claim for refund, but stated that it would "provide recomputed apportionment factors to include total premiums written on all property and risks, other than life insurance, for the years under audit by the Department."

On June 12, 1987, the department issued a notice of action in which it allowed the 100% payroll factor, with the average of premiums and payroll factors returning to 50% as originally reported by the taxpayer on its 1981 through 1983 returns. The result of the department's notice of action was a refund owing to the taxpayer.

Also on June 12, 1987, the department issued notices of action denying each of the taxpayer's claims for refund for various reasons, stating, "It is the department's position that under the provisions of Section 71.01(4)(a)6, Wis. Stats., premium taxes are not deductible. It is also the department's position that under the provisions of Section 71.01(4)(c)1 premiums written mean direct premiums written and not gross or net premiums."

The taxpayer appealed the department's three actions to the Tax Appeals Commission ("the first appeal"). On February 9, 1989, the

Commission signed and filed a settlement stipulation disposing of the first appeal. Two schedules were attached to the settlement stipulation and are incorporated by reference into the language of the stipulation and order signed by the parties and approved by the Commission.

Schedule 1 incorporated in the settlement stipulation begins with "Adjusted Federal Taxable Income per Appellate Action Dated 6/12/87," and adjusts those figures for 1981 through 1983 to reflect amounts allowed by the department for each year for reverse fire department dues and premium taxes to reach an "Adjusted Federal Taxable Income — Amended" ("AFTI—Amended") figure for each year. Next in the Schedule 1 calculations, the product of the "AFTI—Amended" figure and the appropriate multiplier for "Net Gain From Operations, Other Than Life Insurance" produced "Total Income, Other Than Life Insurance." This total income figure was then multiplied by the apportionment percentages from Schedule 2 to produce "Total Income, Other Than Life Insurance, Outside Wisconsin" and, by subtraction, "Wisconsin Net Income." By applying the appropriate tax rates, the Schedule 1 calculations provided an adjusted tax liability for each year and compared this amount with the previously assessed amount per the action by the department's Appellate Bureau to generate an overpayment figure. Finally, the overpayment figure was multiplied by 60% to represent the amount of the claimed overpayment to be conceded by the department to the taxpayer to settle the first appeal. Interest calculated at 9% annually through February 10, 1989, was also applied to the agreed upon overpayment amount in the schedule.

Because of the settlement, the issue of the apportionment percentages was never litigated in a hearing before the

Commission and was never the subject of any findings of fact or conclusions of law by the Commission. The settlement stipulation contains no language addressing how the terms of the settlement, whether incorporated in schedules or otherwise, were to be applied to any subsequent action affecting the tax liabilities of the taxpayer for the years covered by the settlement.

In May 1991, the taxpayer filed amended Wisconsin Insurance Franchise Tax returns for 1979 through 1983 to reflect adjustments made to federal taxable income by the Internal Revenue Service for those years. On the amended returns submitted by the taxpayer, the average of premiums and payroll factors used was 74.3648% for 1981, 74.4910% for 1982, and 77.5295% for 1983. These averages were derived by taking a weighted average of the department's and the taxpayer's positions concerning applicable apportionment percentages prior to settlement of the first appeal, according to a 60% for taxpayer, 40% for department weighting scheme.

The department did not accept the taxpayer's amended Wisconsin returns for 1981 through 1983, its position being that the settlement stipulation was not an agreement between the parties on the apportionment factors but was merely an agreement to refund 60% of the tax refund then in dispute based on the difference in opinion between the parties.

An assessment notice was issued, dated July 25, 1991, in which the department netted amounts of tax and interest due from the 1979 and 1980 taxable years (not at issue here) with amended refund amounts for the 1981 through 1983 taxable years, resulting in an assessment due. In making its calculations, the department applied the same line-by-line analysis detailed



in Schedule 1 attached to the settlement stipulation from the first appeal. As with the first appeal, the calculations began with adjusted federal taxable income, incorporated the taxpayer's adjustments to this figure as reported in the amended returns, and then applied the same multipliers and apportionment percentages used in the settlement schedules to arrive at an adjusted Wisconsin net income and adjusted Wisconsin tax liability for 1981 through 1983. The adjusted Wisconsin tax liability for each year was then compared with the adjusted tax liability previously determined for each year in the settlement schedule from the first appeal to arrive at new figures for overpayment. The revised overpayment figures for each year were multiplied by the 60% compromise factor used in the settlement schedules from the first appeal to arrive at refunds due to the taxpayer, once again applying interest due on the overpayment.

The taxpayer filed a petition for redetermination dated October 3, 1991, which took the position that the settlement stipulation was an agreement between the parties on the apportionment factors to be used for each of the years under review. It was the taxpayer's view that the apportionment figures themselves were to have been weighted by the 60%-40% compromise which it contended was derivative from the settlement schedules incorporated in the stipulation and order from the first appeal.

The Commission reached the following conclusions:

- A. There is no basis for concluding that an agreement or consent of the parties to a weighted average apportionment may be found or derived from the settlement stipulation entered into in the first appeal, because this alleged agreement or consent is not set

forth in the written terms of the settlement agreement or its accompanying schedules as required under sec. 807.05, Wis. Stats., and adequate support for inferring such an agreement has not been provided by the taxpayer. The Commission concluded, however, that the parties did agree upon a methodology for making refund calculations for the 1981 through 1983 taxable years, as set forth in the settlement agreement from the first appeal and as applied by the department in the schedule accompanying its assessment notice dated July 25, 1991.

- B. The taxpayer has failed to show by clear and satisfactory evidence that the department improperly used the "Adjusted Tax Liability" figures from the 1989 settlement stipulation as "Tax Previously Assessed" in the schedule accompanying its assessment notice under review herein.

Therefore, the Commission affirmed the department's action denying the taxpayer's petition for redetermination.

The taxpayer has not appealed this decision. ☐

## SALES AND USE TAXES

**— Claims for refund — time limitation for filing.** *D&S Dental Laboratory, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, June 14, 1995). The issue in this case is whether the taxpayer's refund claim was timely filed.

By notice from the department dated August 1, 1991, a field audit assessment of sales tax was issued against the taxpayer. The taxpayer paid the

field audit assessment by its check dated August 6, 1991, which was received by the department on August 7, 1991.

On August 6, 1993, the department received a refund claim from the taxpayer for the amount of the field audit assessment. The department rejected the taxpayer's refund claim because the refund claim was not received by the department within two years of the field audit assessment issued August 1, 1991.

The taxpayer argues that sec. 77.59(4)(a), Wis. Stats., allows a refund claim to be filed within 2 years after the tax payment date. The department maintains that the refund claim must be filed within 2 years after the assessment date.

The Commission concluded that the taxpayer's refund claim was not timely filed. Because the taxpayer missed the deadline imposed by sec. 77.59(4)(a), Wis. Stats., for filing a claim for refund, neither the department nor the Commission has jurisdiction to consider the taxpayer's claim on its merits.

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

**— Computer software — tangible vs. intangible.** *Wisconsin Department of Revenue vs. Manpower International, Inc.* (Circuit Court for Dane County, June 15, 1995). This is a review of the August 15, 1994 decision of the Wisconsin Tax Appeals Commission. For a summary of that decision, see *Wisconsin Tax Bulletin* 89 (October 1994), page 13. The issues in this case are:

- A. Whether "canned" or "pre-written" software leased by the taxpayer is tangible personal property and subject to sales or use tax.

- B. Whether “canned” or “pre-written” software leased by the taxpayer is an accessory, component, attachment or part to tangible personal property in the form of computer hardware and subject to sales or use tax.
- C. Whether the taxpayer’s lease of “canned” or “pre-written” software is a purchase of a taxable service.

Software, also referred to as a “computer program” or “program,” is any set of specific instructions in a machine-readable form that the computer uses to perform a task. The “instructions” are in machine language, in the form of encoded magnetic impulses, which the computer “reads” electronically in order to enable it to accomplish a specific task.

All the software at issue here is non-custom software, also referred to as “canned” or “pre-written” software. This is in contrast to “custom” software, which is produced to the special order of the customer, usually after extensive review of the customer’s computer hardware and operational needs. “Canned” software is produced in quantity, available for sale to the public, selected by the customer to meet its needs, is generally usable by the customer as written, and is “loaded” into the computer memory by the customer.

Usually when the taxpayer utilizes a new program it is received at the taxpayer’s location on magnetic tape or diskettes and then loaded onto the taxpayer’s computer. The process of “copying” a new program into the computer’s memory unit requires a rearrangement of the memory unit at the molecular level so that the computer’s memory media contains a reproduction of the new program. Memory units in computers are tangi-

ble personal property. However, although the taxpayer received canned software in this manner, it would have been possible to obtain the programs at issue in another form, such as transmitting the programs over telephone lines. Once copied onto the taxpayer’s disk drive, the program can continue being used without ever having to go back to the original tape or diskette (which retains the program unless it is recorded over or magnetically erased). A copy of the tape or diskette is often retained by the taxpayer for “archive” or backup purposes.

With each purchase of software the taxpayer received one or more magnetic tapes or diskettes, along with written manuals. The cost of the blank tape used to transmit the copy of the program is minimal in comparison to the total charge for the program: approximately \$1.00 per blank diskette, and about \$5.00 per blank magnetic tape. The taxpayer cannot demonstrate for any of the programs at issue whether it was instructed by any vendor or software producer to return any magnetic tapes or diskettes after loading the programs, or whether any such tapes or diskettes were in fact returned, retained, or destroyed.

The Court concluded that the taxpayer’s lease of “canned” or “pre-written” software is not subject to sales or use tax.

The answers to the three issues of this case depend on the question of whether “canned” or “pre-written” software is tangible personal property. The Court concluded that canned computer software programs, existing as encoded magnetic impulses, are intangible property.

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

## SALES TAXES AND WITHHOLDING TAXES

— **Personal liability.** *Wisconsin Department of Revenue vs. William Drilias* (Circuit Court for Dane County, June 12, 1995).

The department appeals the Wisconsin Tax Appeals Commission (Commission) decision of August 15, 1994, which cancelled a tax penalty assessment against the taxpayer. The issues are:

- A. Did the Commission correctly conclude that the taxpayer’s failure to pay sales and withholding taxes was neither “willful” nor “intentional,” as defined by the applicable statutes?
- B. Did the Commission erroneously place the burden of proof upon the department to establish that the taxpayer’s failure to pay sales and withholding taxes was “willful” or “intentional”?
- C. Did the Commission’s decision constitute an unexplained deviation from its existing policy of making responsible corporate officers personally liable for intentionally failing to pay corporate sales and withholding taxes?

The taxpayer was an officer of Suburpia Submarine Shoppes, Inc. (the corporation) during the period covered by the assessment, having become the president of the corporation in August of 1982. He had authority over the corporation business affairs until January 31, 1985. On that date, a Bankruptcy Court granted a motion from a Creditors Committee requesting that the corporation be liquidated under Chapter 7, ending the taxpayer’s control over the company.

Tax deficiencies had accumulated during the period from August 1982 through August 1984, when sales and withholding taxes were not paid to the department. An installment agreement was entered into regarding the payment of these deficiencies on August 31, 1984. The terms of the agreement, and the statute granting the department the authority to enter into such agreements, provided that in the event of default, the total unpaid portion of the delinquent accounts would be due and the agreement would be revoked. The taxpayer made weekly payments of \$2,500 on the *past due* withholding taxes, as required by the installment agreement. The assessment includes the past due withholding tax which remained on the installment agreement at the time the taxpayer lost control of the corporation.

In October 1984, the taxpayer filed a late return and payment on *current* taxes. In January 1985, just prior to the Chapter 7 liquidation, the taxpayer failed to pay over *currently* due sales and withholding taxes that had been collected in December 1984 and January 1985.

The Circuit Court remanded the case to the Commission, concluding:

- A. The Commission's legal conclusion that the taxpayer did not willfully or intentionally fail to pay sales and withholding taxes is based upon factual findings that are not supported by substantial evidence in the record. On remand, the Commission is instructed to make explicit what evidence supports its factual findings that the taxpayer complied with the entire installment agreement until he lost control and authority of the corporation, and that there was not time in which to take care of late arising liabilities of the corporation.

B. The Commission is instructed, on remand, to make explicit which party must bear the burden of proof and by which standard the evidence is to be judged.

- C. The Commission must also decide whether the installment agreement changed the corporation's obligation to prefer the state to other creditors, and if so, whether the department is estopped from asserting liability against the taxpayer. Legal conclusions must be made regarding the effect of the department's collection efforts upon the taxpayer's duty to pay (1) the withholding taxes covered by the installment agreement, (2) the withholding taxes not covered by the installment agreement, and (3) the sales taxes. Should these conclusions be a deviation from previous policies, they should be adequately explained in the record.

The taxpayer has not appealed this decision. □

## TEMPORARY RECYCLING SURCHARGE

**— Temporary recycling surcharge — constitutionality.** *Love, Voss & Murray vs. Wisconsin Department of Revenue* (Court of Appeals, District II, June 7, 1995).

The partnership appeals from an order of the Circuit Court for Waukesha County in favor of the Wisconsin Department of Revenue wherein the Circuit Court affirmed the Wisconsin Tax Appeals Commission's decision and held that the Wisconsin recycling surcharge tax for 1991 was constitutional. For summaries of the prior decisions, see *Wisconsin Tax Bulletins* 86 (April

1994), page 20, and 90 (January 1995), page 25.

The partnership is a law practice located in Waukesha, Wisconsin. For 1991, it filed a Form 3S Wisconsin Partnership Temporary Surcharge return. The partnership refused to pay the tax, claiming it was unconstitutional. The department denied the partnership's claim by notice of adjustment.

The partnership challenges, among other things, the constitutionality of sec. 71.94, Wis. Stats. (1991-92), which calculates the surcharge. The partnership argues that "those who get taxed 'for the privilege of doing business in this state' get taxed in a substantially disparate fashion, solely on the basis of whether they are or are not a noncorporate entity engaged in farming."

The Court of Appeals began its analysis with the familiar proposition that "constitutional challenges to a statute must overcome a strong presumption of constitutionality." A party attacking the statute on constitutional grounds has the burden of proving that the statute is unconstitutional beyond a reasonable doubt.

The Circuit Court agreed with the Commission, stating that "the Wisconsin temporary recycling surcharge tax, provided by subch. VII of ch. 77, Stats., is constitutional as it rationally furthers a legitimate state interest."

The Court of Appeals concluded that there is a rational relationship between the classification and a legitimate government purpose; therefore, the statutory sections at issue do not violate the Equal Protection Clause. The Court of Appeals agreed with the Commission that farmers, unlike other businesses, cannot necessarily absorb the recycling surcharge tax

through increasing the prices of their product because of the "vagaries of the commodity marketplace." Additionally, this classification serves a legitimate state interest by giving a partial exemption to a valuable part of Wisconsin's economy which has seen a decrease in numbers.

The partnership also argues that the disparate treatment of noncorporate farmers under the recycling surcharge

is not a reasonable exemption under §1 of Article VIII of the Wisconsin Constitution. Because Wisconsin farmers serve a vital function in this state as well as throughout the country, because they cannot necessarily recoup the tax through raising the prices on their products, and because farm numbers have dropped, the Court of Appeals concluded that the partial exemption of farmers from the recycling surcharge tax is reasonable.

The Court of Appeals affirmed the Circuit Court's order because it concluded that the tax is not violative of the Equal Protection Clause of the United States Constitution and is a reasonable exemption under §1 of Article VIII of the Wisconsin Constitution.

The partnership 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 Adjustments to Interest for Underpayment of Estimated Tax

**Statutes:** Sections 71.09(1)(am), 71.29(1)(a), 71.84 and 77.947, Wis. Stats. (1993-94)

**Note:** This tax release applies only with respect to taxable years beginning on or after January 1, 1994.

**Background:** Individuals, estates, and trusts generally must make estimated tax payments if they expect a tax due (tax, alternative minimum tax, and temporary recycling surcharge, minus credits and withholding) on their return of \$200 or more. Partnerships that expect to owe temporary recycling surcharge of \$200 or more must make estimated surcharge payments. Corporations, including exempt organizations subject to tax on unrelated business taxable income, that expect the sum of their net tax (tax minus credits) and temporary recycling surcharge to be \$500 or more generally must make estimated tax payments. Taxpayers who do not

#### Individual Income Taxes

1. Adjustments to Interest for Underpayment of Estimated Tax (p. 20)
2. Exclusion of Capital Gains on Small Business Stock (p. 21)
3. Passive Activity Losses Allowable to a Nonresident Individual (p. 31)
4. Taxation of Air Carrier Employees (p. 32)
5. Waiver of Interest on Underpayment of Estimated Tax (p. 33)

#### Individual Income and Corporation Franchise and Income Taxes

6. Franchise or Income Tax Nexus — Effect of Intangibles in Wisconsin (p. 34)

#### Sales and Use Taxes

7. Nonprofit Organization's Sales — Admission Event Involves Entertainment (p. 37)
8. Transitional Provisions for Repeal of "Central Office Equipment" Exemption (p. 38)
9. Well Inspection and Water Testing (p. 39)

make the required estimated tax payments are subject to interest on the underpayment. [Sections 71.09, 71.29, 71.84, and 77.947, Wis. Stats. (1993-94).]

For taxable years beginning in 1994, the "return" on which the estimated tax requirements are based is a return that would show the tax properly due.

**Facts and Question 1:** The taxpayer files its 1994 income tax return. The taxpayer did not make the required estimated tax payments throughout the year. The tax return shows a tax due of \$4,000 and underpayment interest of \$320. The department conducts an audit of the taxpayer's 1994 return and determines that the correct tax due is \$5,000. Based on a corrected tax due of \$5,000, underpayment interest would be \$400. May the department issue an assessment for the additional \$80 of underpayment interest (\$400 - \$320)?

**Answer 1:** Yes, the department may issue an assessment to the taxpayer for the additional underpayment interest. For taxable years beginning in 1994, underpayment interest is based on a return that would show the tax properly due.

**Facts and Question 2:** The taxpayer files its 1994 income tax return and pays a tax due of \$10,000 and underpayment interest of \$800. After the due date of the return, the taxpayer determined it had overreported its income, which resulted in an overpayment of tax of \$2,000. Consequently, the correct underpayment interest was \$640. The taxpayer filed an amended 1994 return requesting a refund of tax of \$2,000 and a refund of \$160 of underpayment interest. May the department issue a refund for the underpayment interest?

**Answer 2:** Yes, the department may refund underpayment interest when a taxpayer's net tax is reduced. This

taxpayer would be allowed a refund as follows:

Refund of tax previously paid	\$2,000
Refund of underpayment interest previously paid:	
Underpayment interest from original Schedule U	\$800
Underpayment interest from recomputed Schedule U	<u>640</u>
Difference	<u>160</u>
Amount of refund	<u>\$2,160.</u>

Interest would also be paid on the refund of tax (\$2,000) at the rate of 9% from the original due date of the return to the date of the refund. Wisconsin law does not provide for interest to be paid on the \$160 refund of underpayment interest.

**Facts and Question 3:** The taxpayer's 1994 income tax return showed a tax due of \$1,000; therefore, he makes \$1,000 of estimated tax payments for 1995. The taxpayer's 1995 income tax return reports net tax due of \$5,000. The taxpayer does not pay any underpayment interest for 1995 because he had made estimated tax payments equal to 100% of his 1994 tax liability. The department conducts an audit of the taxpayer's 1994 return and determines that the correct tax due is \$6,000. In addition to assessing additional underpayment interest for 1994, if applicable, may the department assess underpayment interest for 1995?

**Answer 3:** Yes, the department may assess underpayment interest for 1995. Based on the corrected tax due for 1994, the taxpayer was required to make estimated tax payments for 1995 of \$4,500, which is the lesser of

90% of his 1995 tax liability of \$5,000 or 100% of his corrected 1994 tax liability of \$6,000. Because the taxpayer only made estimated tax payments of \$1,000 for 1995, the department may assess underpayment interest. □

## 2 Exclusion of Capital Gains on Small Business Stock

**Statutes:** Sections 71.01(10) and 71.05(6)(b)6, Wis. Stats. (1987-88), (1989-90), (1991-92), and (1993-94)

**Note:** This tax release supersedes the tax release titled "Exclusion of Capital Gains on Small Business Stock" which appeared in *Wisconsin Tax Bulletin* 68 (July 1990), page 15.

**Background:** Under sec. 71.05(6)(b)6, Wis. Stats. (1987-88), (1989-90), (1991-92), and (1993-94), certain taxpayers may subtract capital gains on "small business stock" from federal adjusted gross income when computing Wisconsin taxable income. The exclusion is available if the taxpayer submits with the Wisconsin income tax return a copy of a certification from the corporation issuing the stock. Section 71.01(10), Wis. Stats. (1987-88), (1989-90), (1991-92), and (1993-94), defines "small business stock" and lists the items that must be included on the certification.

Under sec. 71.01(10), Wis. Stats. (1987-88), (1989-90), (1991-92), and (1993-94), small business stock means an equity security that the taxpayer has held for at least five years and that is issued by a corporation that meets certain requirements as of specific dates and so certifies to the taxpayer. The requirements and applicable dates are specified in sec. 71.01(10).

The small business stock capital gains exclusion was enacted as part of 1985

Wisconsin Act 29, which created secs. 71.02(2)(fr) and 71.05(1)(b)12, Wis. Stats., effective for stock issued to a taxpayer on or after January 1, 1986. Sections 71.02(2)(fr) and 71.05(1)(b)12 were subsequently renumbered secs. 71.01(10) and 71.05(6)(b)6, respectively, effective January 1, 1989.

**Question 1:** What requirements must be met for stock to be treated as "small business stock" under sec. 71.01(10), Wis. Stats., and what are the applicable dates on which these requirements must be met?

**Answer 1:** The answer depends on when the stock is issued to the taxpayer. The requirements and applicable dates for meeting the requirements were amended by 1987 Wisconsin Act 27, effective for stock issued on or after August 31, 1987. The requirements were again amended by 1987 Wisconsin Act 399, effective for stock issued in the corporation's taxable year 1988 and thereafter. Following are the requirements and applicable dates for meeting them for the various dates of acquisition.

**A. From January 1, 1986, to August 30, 1987**

For stock issued from January 1, 1986, to August 30, 1987, the requirements that must be met for stock to be treated as small business stock and the applicable dates for meeting these requirements are as follows:

1. At least 50% of the corporation's property and at least 50% of its payroll were in Wisconsin on the December 31 before issuance of the stock.
2. The corporation had no more than 200 employees covered by Wisconsin unemployment insurance, including employees of any corporation that owned more

than 50% of the issuing corporation's stock, on the December 31 before issuance of the stock.

3. The corporation derived no more than 25% of its gross receipts from rents, interest, dividends, and sales of assets combined in the calendar year prior to issuance of the stock.
4. The corporation had no stock listed on the New York Stock Exchange, the American Stock Exchange, or the National Association of Securities Dealers' Automated Quotation system on the December 31 before issuance of the stock.
5. The corporation had not conducted a trade or business in corporate or noncorporate form, or a combination thereof, for a period of more than five years prior to the December 31 before issuance of the stock.
6. The corporation had never liquidated its assets in whole or in part for tax purposes only in order to fulfill requirements 1 to 5 above and then reorganized, as of the December 31 before issuance of the stock.

**B. On or After August 31, 1987 — Corporation Incorporated in a Prior Year**

For stock issued on or after August 31, 1987, by a corporation incorporated prior to the calendar year in which the stock is issued, the requirements that must be met for stock to be treated as small business stock and the applicable dates for meeting these requirements are as follows:

1. At least 50% of the corporation's property and at least 50% of its payroll were in Wisconsin on the December 31 before issuance of the stock.

2. The corporation had no more than 500\* employees covered by Wisconsin unemployment insurance, including employees of any corporation that owned more than 50% of the issuing corporation's stock, on the December 31 before issuance of the stock.

\* **Note:** For stock issued from August 31, 1987, to the end of the corporation's 1987 taxable year, the number of employees is 200 rather than 500.

3. The corporation derived no more than 25% of its gross receipts from rent, interest, dividends, and sales of intangible investment assets combined in the calendar year prior to issuance of the stock. However, if the corporation had been incorporated for two calendar years or less as of the date the stock is issued and derived less than \$3,000 of that type of income during that time, the 25% gross receipts limitation does not apply.

**Example:** ABC Corporation, incorporated on March 1, 1985, issues stock to a taxpayer on June 30, 1988. The 25% gross receipts limitation applies to ABC's gross receipts for calendar year 1987. However, if ABC had been incorporated on or after June 30, 1986 (two years or less prior to the issuance of the stock), the 25% gross receipts limitation would not apply if ABC derived less than \$3,000 of gross receipts from rents, interest, dividends, and sales of intangible investment assets combined from the date of incorporation to June 30, 1988.

4. The corporation had no stock listed on the New York Stock Exchange, the American Stock Exchange, or the National Association of Securities Dealers' Automated Quotation system on the December 31 before issuance of the stock.

5. The corporation had never liquidated its assets in whole or in part for tax purposes only in order to fulfill requirements 1 to 4 above and then reorganized, as of the December 31 before issuance of the stock.

**C. On or After August 31, 1987 — Corporation Incorporated During the Year**

For stock issued on or after August 31, 1987, by a corporation incorporated during the calendar year in which the stock is issued, the requirements that must be met for stock to be treated as small business stock and the applicable dates for meeting these requirements are as follows:

1. At least 50% of the corporation's property and at least 50% of its payroll were in Wisconsin on the date the stock was issued.
  2. The corporation had no more than 500\* employees covered by Wisconsin unemployment insurance, including employees of any corporation that owned more than 50% of the issuing corporation's stock, on the date the stock was issued.
- \* **Note:** For stock issued from August 31, 1987, to the end of the corporation's 1987 taxable year, the number of employees is 200 rather than 500.
3. The corporation derived no more than 25% of its gross receipts from rent, interest, dividends, and sales of intangible investment assets combined from the date of incorporation to the date the stock was issued. However, if the corporation derived less than \$3,000 of that type of income during that time, the 25% gross receipts limitation does not apply.

**Example:** DEF Corporation, incorporated on January 2, 1991, issues stock to a taxpayer on June 30, 1991. The 25% gross receipts limitation applies to DEF's gross receipts from the date of incorporation to June 30, 1991. However, if DEF's gross receipts from rents, interest, dividends, and sales of intangible investment assets combined were less than \$3,000 for that time period, the 25% gross receipts limitation does not apply.

4. The corporation had no stock listed on the New York Stock Exchange, the American Stock Exchange, or the National Association of Securities Dealers' Automated Quotation system on the date the stock was issued.
5. The corporation had never liquidated its assets in whole or in part for tax purposes only in order to fulfill requirements 1 to 4 above and then reorganized, as of the date the stock was issued.

**Question 2:** With respect to stock issued from January 1, 1986, to August 30, 1987 (Part A of Answer 1), how do the requirements apply for a corporation that was not yet incorporated as of the December 31 before issuance of the stock?

**Answer 2:** Requirements 1, 2, 3, 4, and 6 in Part A of Answer 1 are considered to have been met as of the December 31 before the stock issuance. Only failure to fulfill requirement 5 would preclude stock issued by such a corporation from qualifying as "small business stock."

**Question 3:** To which year's tax return must the taxpayer attach the certification?

**Answer 3:** The taxpayer must attach the certification to the tax return on which the capital gains exclusion is claimed. Do not submit the certifica-

tion with the tax return for the year in which the stock is acquired.

**Question 4:** To qualify for the capital gains exclusion in sec. 71.05(6)(b)6, must the issuing corporation give the taxpayer the certification required under sec. 71.01(10) at the time of issuance of the stock?

**Answer 4:** No. However, since the taxpayer must include the certification with the income tax return on which the capital gains exclusion is claimed, the issuing corporation must give the certification to the taxpayer prior to the time for filing that tax return. The Department of Revenue prefers that it be given as soon as reasonably possible after the stock is issued.

**Question 5:** Is there a form on which the issuing corporation may make the required certification?

**Answer 5:** No, there is no prescribed form. However, for guidelines concerning the information to include on a certification, refer to the three samples at the end of this tax release. These samples reflect the requirements and applicable dates for meeting them, as described in Answer 1.

The issuing corporation must provide a separate certification for each separate block of stock issued.

[Editor's Note: For purposes of this Bulletin, the samples are on pages 46 to 48.]

**Question 6:** If a corporation meets the small business stock requirements as of the December 31 before the stock is issued (or as of the date of issuance for stock issued by a new corporation after August 30, 1987) and the corporation so certifies, would the capital gains exclusion continue to apply if the corporation subsequently fails to meet all of the requirements?

**Answer 6:** Yes. If the corporation meets the requirements as of the applicable dates and so certifies, the fact that the corporation subsequently does not meet one or more of the requirements does not alter the character of the stock as small business stock.

**Question 7:** What additional requirements must be met for a taxpayer to be entitled to the capital gains exclusion for small business stock?

**Answer 7:** The capital gains exclusion for small business stock is available only to individuals and fiduciaries who meet certain additional requirements. The eligibility requirements in sec. 71.05(6)(b)6, Wis. Stats., were amended by 1991 Wisconsin Act 39, effective for stock issued on or after August 16, 1991. Following are the eligibility requirements for the various dates of acquisition.

**A. From January 1, 1986, to August 15, 1991**

For stock issued from January 1, 1986, to August 15, 1991, the eligibility requirements for claiming the capital gains exclusion are as follows:

The capital gains exclusion applies only to the person who initially acquired the stock from the corporation. The stock must be issued directly by the corporation to the person claiming the capital gains exclusion. It cannot be acquired from a secondary source, such as through a purchase from a shareholder of a corporation, rather than from the corporation itself.

The taxpayer's stock acquisition from the corporation may be by purchase or it may be by some other means, such as a stock dividend, a stock split, or a stock-for-stock exchange; however, the acquisition may not be by gift.

**B. On or After August 16, 1991**

For stock issued on or after August 16, 1991, the eligibility requirements for claiming the capital gains exclusion are as follows:

The capital gains exclusion applies only to the original purchaser of small business stock that is purchased at the time that the business is incorporated. The stock must be purchased from the corporation. It may not be acquired by some other means such as a stock dividend, stock split, stock-for-stock exchange, or gift. The stock cannot be acquired from a secondary source, such as through a purchase from a shareholder of a corporation, rather than from the corporation itself.

The stock must be shares that were authorized and issued as part of the initial stock offering during the incorporation process. Shares subsequently purchased from the corporation do not qualify for the capital gains exclusion even though the shares were authorized in the original articles of incorporation.

**Question 8:** Does the capital gains exclusion for small business stock apply with respect to stock issued as a stock dividend? (**Note:** A stock dividend is a capitalization of earnings or profits, together with a distribution of the added shares which evidence the assets transferred to capital.)

**Answer 8:** The answer depends on when the stock is issued, illustrated as follows:

**A. From January 1, 1986, to August 15, 1991**

Stock issued as a stock dividend from January 1, 1986, to August 15, 1991, may qualify as small business stock if

the corporation meets the requirements under sec. 71.01(10), Wis. Stats., as of the December 31 prior to issuance of the stock (assuming the corporation was incorporated in a year prior to the issuance of the stock).

Since the stock is not acquired by gift, the capital gains exclusion applies, provided the taxpayer holds the stock for at least five years and submits the certification with the tax return on which the capital gain is reported.

**Example 1:** Prior to 1986, Taxpayer Z acquired 100 shares of GHI Corporation stock that do not qualify as small business stock. GHI declared a stock dividend and, on September 1, 1988, issued one-quarter of a share of stock for each share owned by the shareholders. Therefore, Taxpayer Z received an additional 25 shares. GHI met the small business stock requirements as of December 31, 1987, and so certified to each shareholder.

Since Taxpayer Z did not acquire the 25 shares of GHI stock issued on September 1, 1988, by gift, he may claim the small business stock capital gains exclusion for these 25 shares, provided he holds them until September 1, 1993, and submits the certification with the tax return on which the capital gain is reported. Taxpayer Z's original 100 shares of GHI stock do not qualify for the small business stock capital gains exclusion.

**Example 2:** On June 15, 1988, Taxpayer Y acquired 100 shares of JKL Corporation stock that do not qualify as small business stock. JKL declared a stock dividend and, on February 1, 1990, issued one-half of a share of stock for each share owned by the shareholders. Therefore, Taxpayer Y received an additional 50 shares. JKL met the small business stock requirements as of December 31, 1989, and so certified to each shareholder.

Since Taxpayer Y did not acquire the 50 shares of JKL stock issued on February 1, 1990, by gift, she may claim the small business stock capital gains exclusion for



these 50 shares, provided she holds them until February 1, 1995, and submits the certification with the tax return on which the capital gain is reported. Taxpayer Y's original 100 shares of JKL stock do not qualify for the small business stock capital gains exclusion.

### **B. On or after August 16, 1991**

Stock issued as a stock dividend on or after August 16, 1991, does not qualify for the small business stock capital gains exclusion since it is not purchased from the corporation at the time of incorporation. A stock dividend does not qualify for the capital gains exclusion even though attributable to stock that qualifies as small business stock.

**Example 1:** Prior to 1986, Taxpayer X acquired 200 shares of MNO Corporation stock that do not qualify as small business stock. MNO declared a stock dividend and, on October 1, 1991, issued one-half of a share of stock for each share owned by the shareholders. Therefore, Taxpayer X received an additional 100 shares. MNO met the small business stock requirements as of December 31, 1990.

The 100 shares of MNO stock issued to Taxpayer X on October 1, 1991, do not qualify for the small business stock capital gains exclusion since Taxpayer X did not purchase them from the corporation at the time of incorporation.

**Example 2:** On January 15, 1992, Taxpayer W acquired 500 shares of PQR Corporation stock that do not qualify as small business stock. PQR declared a stock dividend and, on March 15, 1994, issued one-half of a share of stock for each share owned by the shareholders. Therefore, Taxpayer W received an additional 250 shares. PQR met the small business stock requirements as of December 31, 1993, and so certified to each shareholder.

The 250 shares of PQR stock issued to Taxpayer W on March 15, 1994, do not qualify for the small business stock capital gains exclusion since Taxpayer W did

not purchase them from the corporation at the time of incorporation.

**Example 3:** Taxpayer V purchased 100 shares of STU Corporation stock on December 1, 1987, and received certification that the shares qualify as small business stock. STU declared a stock dividend and, on September 1, 1991, issued one-quarter of a share of stock for each share owned by the shareholders. Therefore, Taxpayer V received an additional 25 shares. STU met the small business stock requirements as of December 31, 1990.

The 25 shares of STU stock issued to Taxpayer V on September 1, 1991, do not qualify for the small business stock capital gains exclusion since Taxpayer V did not purchase them from the corporation at the time of incorporation. However, Taxpayer V may claim the capital gains exclusion for the 100 shares of STU stock issued on December 1, 1987, which qualify as small business stock, provided she holds them until December 1, 1992, and submits the certification with the tax return on which the capital gain is reported.

**Example 4:** Taxpayer U purchased 300 shares of VWX Corporation stock on September 15, 1993, and received certification that the shares qualify as small business stock. VWX declared a stock dividend and, on April 1, 1995, issued one-third of a share of stock for each share owned by the shareholders. Therefore, Taxpayer U received an additional 100 shares. VWX met the small business stock requirements as of December 31, 1994.

The 100 shares of VWX stock issued to Taxpayer U on April 1, 1995, do not qualify for the small business stock capital gains exclusion since Taxpayer U did not purchase them from the corporation at the time of incorporation. However, Taxpayer U may claim the capital gains exclusion for the 300 shares of VWX stock issued on September 15, 1993, which qualify as small business stock, provided she holds them until September 15, 1998, and submits the certification with the tax return on which the capital gain is reported.

**Question 9:** Does the capital gains exclusion for small business stock apply with respect to stock issued as a result of a stock split? (**Note:** A stock split is an increase in the number of shares which evidence ownership without a change in the amount of capital, surplus, or segregated earnings.)

**Answer 9:** The answer depends on whether or not the original shares qualify as small business stock under sec. 71.01(10), Wis. Stats., and, if they do not qualify, on when the new shares are issued, illustrated as follows:

### **A. Original Shares Qualify as Small Business Stock**

If the original shares of stock qualify as small business stock under sec. 71.01(10), Wis. Stats., new shares issued after January 1, 1986, as the result of a stock split will also qualify for the capital gains exclusion. In this situation, the issuance of new stock certificates to evidence the split up of the original shares of stock is not considered the issuance of new or additional stock. The new shares issued will qualify for the exclusion even though the corporation no longer meets the requirements under sec. 71.01(10), Wis. Stats., on the December 31 prior to the stock split (assuming the corporation was incorporated in a year prior to the issuance of the stock). In this situation, the holding period begins when the original shares were issued.

The capital gains exclusion applies provided the taxpayer holds the stock for at least five years from the date of acquisition of the original shares and submits the certification with the tax return on which the capital gain is reported.

**Example 1:** Taxpayer T acquired 100 shares of YZA Corporation stock on November 1, 1988, and received certifi-

cation that the shares qualify as small business stock. YZA declared a two-for-one stock split and, on June 1, 1991, issued one share of stock for each share owned by the shareholders. Therefore, Taxpayer T retained her original stock certificate and received another stock certificate for the additional 100 shares. YZA no longer met the requirements under sec. 71.01(10), Wis. Stats., as of December 31, 1990.

Since Taxpayer T's original 100 shares of YZA stock qualify as small business stock, the additional 100 shares that she received in the stock split will also qualify as small business stock even though YZA no longer meets the small business stock requirements. To qualify for the capital gains exclusion, Taxpayer T must hold the 200 shares of YZA stock until November 1, 1993, and submit the certification with the tax return on which the capital gain is reported. In this situation, the holding period begins when the original shares were issued.

**Example 2:** Taxpayer S purchased 200 shares of BCD Corporation stock on June 1, 1992, and received certification that the shares qualify as small business stock. BCD declared a two-for-one stock split in which the shareholders surrendered their old shares of stock and received two new shares for each share surrendered. BCD issued the new shares on September 1, 1994. Taxpayer S has 400 shares of BCD stock after the stock split. BCD no longer met the requirements under sec. 71.01(10) as of December 31, 1993.

Since Taxpayer S's original 200 shares of BCD stock qualify as small business stock, her 400 replacement shares issued on September 1, 1994, will continue to qualify as small business stock even though the corporation no longer meets the small business stock requirements. To qualify for the capital gains exclusion, Taxpayer S must hold the 400 shares of BCD stock until June 1, 1997, and submit the certification with the tax return on which the capital gain is reported.

#### **B. Original Shares Do Not Qualify as Small Business Stock**

If the original shares of stock do not qualify as small business stock under

sec. 71.01(10), Wis. Stats., the treatment of shares issued as a stock split depends on when the new shares are issued:

##### **1. From January 1, 1986, to August 15, 1991**

Stock issued as a result of a stock split from January 1, 1986, to August 15, 1991, may qualify as small business stock, provided the corporation meets the requirements under sec. 71.01(10), Wis. Stats., as of the December 31 prior to issuance of the stock (assuming the corporation was incorporated in a year prior to the issuance of the stock).

Since the new shares are not acquired by gift, the small business stock capital gains exclusion applies, provided the taxpayer holds the stock for at least five years and submits the certification with the tax return on which the capital gain is reported.

**Example:** Prior to 1986, Taxpayer R acquired 100 shares of EFG Corporation stock that do not qualify as small business stock. EFG declared a three-for-one stock split and, on July 1, 1990, issued an additional two shares of stock for each share owned by the shareholders. Therefore, Taxpayer R retained his original stock certificate and received another stock certificate for the additional 200 shares. EFG met the small business stock requirements as of December 31, 1989, and so certified to the shareholders.

Since Taxpayer R did not acquire the 200 shares of EFG stock issued on July 1, 1990, by gift, he may claim the capital gains exclusion, provided he holds them until July 1, 1995, and submits the certification with the tax return on which the capital gain is reported. Taxpayer R's original 100 shares of EFG stock do not qualify for the small business stock capital gains exclusion.

##### **2. On or after August 16, 1991**

Stock issued as a result of a stock split on or after August 16, 1991, does not qualify for the small business stock capital gains exclusion even though the corporation meets the requirements under sec. 71.01(10), Wis. Stats., as of the December 31 prior to issuance of the stock (assuming the corporation was incorporated in a year prior to the issuance of the stock).

The capital gains exclusion does not apply since the new stock certificates evidence the split up of existing shares of stock that do not qualify as small business stock.

**Example 1:** Prior to 1986, Taxpayer Q acquired 900 shares of HIJ Corporation stock that do not qualify as small business stock. HIJ declared a four-for-one stock split and, on October 1, 1991, issued an additional three shares of stock for each share owned by the shareholders. Therefore, Taxpayer Q retained her original stock certificate and received another stock certificate for the additional 2,700 shares. HIJ met the small business stock requirements as of December 31, 1990.

The 2,700 shares of HIJ stock issued to Taxpayer Q on October 1, 1991, do not qualify for the small business stock capital gains exclusion since Taxpayer Q's original 900 shares do not qualify as small business stock.

**Example 2:** On February 1, 1992, Taxpayer P acquired 600 shares of KLM Corporation stock that do not qualify as small business stock. KLM declared a two-for-one stock split and, on November 15, 1994, issued an additional share of stock for each share owned by the shareholders. Therefore, Taxpayer P retained her original stock certificate and received another stock certificate for the additional 600 shares. KLM

met the small business stock requirements as of December 31, 1993.

The 600 shares of KLM stock issued to Taxpayer P on November 15, 1994, do not qualify for the small business stock capital gains exclusion since Taxpayer P's original 600 shares do not qualify as small business stock.

**Question 10:** How does the capital gains exclusion for small business stock apply with respect to a corporate reorganization?

**Answer 10:** The answer depends on the type of reorganization, which stock shares are reissued, and when the stock is issued, illustrated as follows:

#### A. Consolidation

If two or more corporations consolidate forming a new corporation that issues all replacement shares, the treatment depends on when the replacement stock is issued:

##### 1. *From January 1, 1986, to August 15, 1991*

Replacement stock issued pursuant to a consolidation from January 1, 1986, to August 15, 1991, is considered small business stock if the new corporation meets the requirements under sec. 71.01(10), Wis. Stats., at the time it issues the replacement stock and so certifies to each shareholder.

Since the replacement stock is not acquired by gift, the capital gains exclusion applies, provided the taxpayer holds the replacement stock for at least five years and submits the certification with the tax return on which the capital gain is reported.

**Example:** NOP and QRS Corporations consolidated into new TUV Corporation on November 1, 1987.

On that date, TUV issued replacement shares to the shareholders of the NOP and QRS stock. TUV met the small business stock requirements as of November 1, 1987, and so certified to each shareholder.

Since the replacement stock was not acquired by gift, the capital gains exclusion applies to each taxpayer who holds the stock until November 1, 1992, and submits the certification with the tax return on which the capital gain is reported.

##### 2. *On or after August 16, 1991*

Replacement stock issued pursuant to a consolidation on or after August 16, 1991, does not qualify for the capital gains exclusion since the exclusion does not apply to stock acquired in a stock-for-stock exchange. The replacement shares do not qualify for the capital gains exclusion even if the original shares of stock in the consolidating corporations qualify as small business stock.

**Example:** WXY and ZAB Corporations consolidated into new CDE Corporation on December 1, 1991. On that date, CDE issued replacement shares to the shareholders of the WXY and ZAB stock. CDE met the small business stock requirements as of December 1, 1991.

Since the CDE replacement stock was issued in a stock-for-stock exchange, the capital gains exclusion does not apply to the shareholders who receive CDE stock in exchange for their previously owned WXY or ZAB stock. The capital gains exclusion would not apply even if the original shares of WXY and ZAB stock had qualified as small business stock.

**Note:** If, as part of the incorporation process, additional shares of stock are authorized and issued to new investors who purchase the shares from the

corporation at the time of incorporation and receive certification that the shares qualify as small business stock, these new investors may qualify for the capital gains exclusion. A new investor must hold the stock for at least five years and submit the certification with the tax return on which the capital gain is reported.

#### B. Merger — Replacement Shares Issued to All Shareholders

If two or more corporations merge into a surviving corporation that reissues all stock shares, the treatment depends on when the replacement stock is issued:

##### 1. *From January 1, 1986, to August 15, 1991*

Replacement stock issued pursuant to a merger to the shareholders of both the liquidating and the surviving corporations from January 1, 1986, to August 15, 1991, is considered small business stock if the surviving corporation meets the requirements under sec. 71.01(10), Wis. Stats., as of the December 31 before the stock is reissued (assuming the surviving corporation was originally incorporated in a year prior to reissuance of the stock) and the surviving corporation so certifies to each shareholder.

Since the replacement stock was not acquired by gift, the capital gains exclusion applies, provided the taxpayer holds the replacement stock for at least five years and submits the certification with the tax return on which the capital gain is reported.

**Example:** FGH and IJK Corporations, both incorporated in 1986, merged into IJK Corporation on

January 1, 1988. On that date, IJK issued replacement stock shares to all of the shareholders of the previous FGH and IJK stock. IJK met the small business stock requirements as of December 31, 1987, and so certified to each shareholder.

Since the IJK replacement stock was not acquired by gift, the capital gains exclusion applies to each taxpayer who holds the stock until January 1, 1993, and submits the certification with the tax return on which the capital gain is reported.

2. ***On or after August 16, 1991 — Shareholders of Liquidating Corporation***

Replacement stock issued pursuant to a merger to the shareholders of the liquidating corporation on or after August 16, 1991, do not qualify for the capital gains exclusion since the exclusion does not apply to stock acquired in a stock-for-stock exchange or to stock issued after the time of incorporation. The replacement shares do not qualify for the capital gains exclusion even if the original shares of stock in the liquidating corporation qualify as small business stock.

**Example:** LMN and OPQ Corporations, both incorporated in 1986, merged into OPQ Corporation on December 1, 1991. On that date, OPQ issued replacement stock shares to all of the shareholders of the previous LMN and OPQ stock. OPQ met the small business stock requirements as of December 31, 1990.

Since the OPQ replacement stock was not issued at the time of incorporation and it was issued in a stock-for-stock exchange, the capital gains exclusion does not apply to the shareholders who receive OPQ stock in exchange for their previously owned LMN stock. The capital gains exclusion would not apply even though the original shares of

LMN stock had qualified as small business stock.

3. ***On or after August 16, 1991 — Shareholders of Surviving Corporation***

Replacement stock issued pursuant to a merger to the shareholders of the surviving corporation on or after August 16, 1991, qualifies for the capital gains exclusion if their original shares of stock qualify as small business stock. In this situation, the holding period begins when the original shares were issued.

**Example:** RST and UVW Corporations merged into UVW Corporation on November 1, 1991. On that date, UVW issued replacement shares to all of the shareholders of the previous RST and UVW stock. Taxpayer O purchased stock from UVW on August 1, 1986, and received certification from UVW that the stock qualifies as small business stock. Taxpayer O sells the stock at a gain on September 1, 1992, and attaches the certification to her 1992 income tax return.

The capital gains exclusion applies since Taxpayer O held the stock for more than five years (August 1, 1986, to September 1, 1992). The merger has no effect on the holding period for UVW stock acquired prior to the merger.

C. ***Merger — Replacement Shares Issued Only to Shareholders of Liquidating Corporation***

If two or more corporations merge into a surviving corporation that reissues stock shares to replace those held by shareholders of the liquidating corporation but does not reissue stock to shareholders of the surviving corporation, the following treatment applies:

1. For shareholders of the liquidating corporation, the treatment

is the same as described in Answer 10, Part B.1. and 2., above.

2. For shareholders of the surviving corporation, the small business requirements and five-year holding period with respect to the shares that are not reissued go back to the original applicable date. The capital gains exclusion for those shares applies as if no merger had occurred.

D. ***"F" Reorganization***

If a parent corporation merges into its 100% owned subsidiary solely for the purpose of changing its state of incorporation and the transaction qualifies as an "F" reorganization under sec. 368(a)(1)(F) of the Internal Revenue Code, the treatment depends on when the replacement stock is issued:

1. ***From January 1, 1986, to August 15, 1991***

Replacement stock issued in an F reorganization from January 1, 1986, to August 15, 1991, may qualify as small business stock if the corporation meets the requirements under sec. 71.01(10), Wis. Stats., as of the December 31 prior to the issuance of the stock (assuming the corporation was incorporated in a year prior to the issuance of the stock).

**Example:** DEL Corporation, which was incorporated in Delaware prior to 1986, organized and owned 100% of the stock of WIS Corporation, a subsidiary corporation incorporated in Wisconsin. On January 1, 1989, DEL Corporation merged into WIS Corporation. The operations of DEL Corporation became those of WIS Corporation, and DEL Corporation ceased to exist as a corporation. WIS Corporation issued replacement shares to all of the shareholders of the previous DEL Corporation stock. WIS Corporation met the

small business stock requirements on January 1, 1989.

Since the WIS Corporation replacement stock was not acquired by gift, the capital gains exclusion applies to each taxpayer who holds the stock until January 1, 1994, and submits the certification with the tax return on which the capital gain is reported.

## 2. *On or after August 16, 1991*

Replacement stock issued in an F reorganization on or after August 16, 1991, does not qualify for the capital gains exclusion since the exclusion does not apply to stock acquired in a stock-for-stock exchange. The replacement shares do not qualify for the capital gains exclusion even if the original shares of stock in the merged corporation qualify as small business stock.

**Example:** WIS corporation, which was incorporated in Wisconsin in 1987, organized and owned 100% of the stock of NEV Corporation, a subsidiary corporation incorporated in Nevada. On April 1, 1992, WIS Corporation merged into NEV Corporation. The operations of WIS Corporation became those of NEV Corporation, and WIS Corporation ceased to exist as a corporation. NEV Corporation issued replacement shares to all shareholders of the previous WIS Corporation stock. NEV Corporation met the small business stock requirements on April 1, 1992.

Since the NEV Corporation replacement stock was issued in a stock-for-stock exchange, the capital gains exclusion does not apply to the shareholders who receive NEV Corporation stock in exchange for their previously owned WIS Corporation stock. The capital gains exclusion would not apply even though the original shares of WIS Corporation stock had qualified as small business stock.

**Question 11:** Does the capital gains exclusion for small business stock apply with respect to stock issued in a recapitalization?

**Answer 11:** The answer depends on when the new shares are issued, illustrated as follows:

### A. *From January 1, 1986, to August 15, 1991*

The new shares issued in a recapitalization from January 1, 1986, to August 15, 1991, may qualify as small business stock, provided the corporation meets the requirements under sec. 71.01(10), Wis. Stats., as of the December 31 prior to issuance of the stock (assuming the corporation was incorporated in a year prior to the issuance of the stock).

Since the new shares are not acquired by gift, the small business stock capital gains exclusion applies, provided the taxpayer holds the stock for at least five years and submits the certification with the tax return on which the capital gain is reported.

**Example:** Taxpayer N acquired 100 shares of XYZ Corporation common stock prior to 1986 that do not qualify as small business stock. On April 1, 1990, as part of a recapitalization, Taxpayer N surrendered the 100 shares of common stock and in exchange received 100 shares of XYZ preferred stock. XYZ met the requirements under sec. 71.01(10), Wis. Stats., as of December 31, 1989, and so certified to the shareholders.

Since Taxpayer N did not acquire the 100 shares of XYZ preferred stock issued on April 1, 1990, by gift, he may claim the capital gains exclusion, provided he holds them until April 1, 1995, and submits the certification with the tax return on which the capital gain is reported.

### B. *On or After August 16, 1991*

The new shares issued in a recapitalization on or after August 16,

1991, do not qualify for the small business stock capital gains exclusion. The new shares issued do not qualify for the capital gains exclusion even if the original shares qualify as small business stock under sec. 71.01(10), Wis. Stats., or the corporation meets the requirements under sec. 71.01(10), Wis. Stats., as of the December 31 prior to the issuance of the stock (assuming the corporation was incorporated in a year prior to the issuance of the stock).

The capital gains exclusion does not apply since the new shares are not the original shares that were authorized and issued by the corporation at the time of incorporation.

**Example 1:** Taxpayer M acquired 500 shares of ABC Corporation common stock on March 1, 1989, and received certification that the shares qualify as small business stock. On October 1, 1991, as part of a recapitalization, Taxpayer M surrendered the 500 shares of common stock and in exchange received 500 shares of ABC preferred stock. ABC met the requirements under sec. 71.01(10), Wis. Stats., as of December 31, 1990.

The 500 shares of ABC preferred stock issued to Taxpayer M on October 1, 1991, do not qualify for the small business stock capital gains exclusion since they are not the original shares authorized and issued by the corporation at the time of incorporation.

**Example 2:** Taxpayer L acquired 300 shares of DEF Corporation common stock prior to 1986 that do not qualify as small business stock. On August 1, 1993, as part of a recapitalization, Taxpayer L surrendered the 300 shares of DEF common stock and in exchange received 300 shares of DEF preferred stock. DEF met the requirements under sec. 71.01(10), Wis. Stats., as of December 31, 1992.

The 300 shares of DEF preferred stock issued to Taxpayer L on August 1, 1993, do not qualify for the small business stock capital gains exclusion since they are not the original shares authorized and

issued by the corporation at the time of incorporation.

**Question 12:** If stock that qualifies as small business stock is held by a spouse as individual property and later reclassified as marital property, may the entire gain on the sale of the stock qualify for the small business stock capital gains exclusion?

**Answer 12:** No. Only the gain realized on the ownership interest retained by the original owner may qualify for the small business stock capital gains exclusion. At the time of reclassification, the shareholder's spouse becomes the owner of one-half of the stock that is reclassified as marital property. The gain on the portion of the stock owned by the shareholder's spouse as a result of the reclassification does not qualify for the small business stock capital gains exclusion.

For transfers occurring prior to August 16, 1991, the small business stock capital gains exclusion applies only to the person who initially acquired the stock from the corporation. Stock acquired by gift does not qualify for the exclusion. Under Internal Revenue Code sec. 1041, the transfer of property from an individual to a spouse is treated as a gift.

For stock transferred on or after August 16, 1991, the exclusion is available only to the original purchaser of small business stock that is purchased at the time that the business is incorporated.

**Example:** Prior to his marriage in 1989, Taxpayer K acquired 100 shares of GHI Corporation stock that qualify as small business stock under sec. 71.01(10), Wis. Stats. The stock is Taxpayer K's individual property. On September 1, 1991, Taxpayer K and his spouse executed a marital property agreement that reclassified the GHI stock as marital property. Taxpayer K and his spouse sell the GHI

stock on October 1, 1996, and realize a gain of \$12,000.

The one-half of the gain (\$6,000) attributable to Taxpayer K's ownership interest qualifies for the small business stock capital gains exclusion, provided he attaches a copy of the certification to his separate tax return or to their joint tax return. The remaining \$6,000 of the gain, which is attributable to his spouse's ownership interest, does not qualify for the capital gains exclusion for small business stock.

**Question 13:** If the owner of stock that qualifies as small business stock contributes it to a revocable living trust of which he or she is the principal beneficiary, may the gain on the sale of the stock qualify for the small business stock capital gains exclusion?

**Answer 13:** Yes. The gain on the sale of the stock may qualify for the small business stock capital gains exclusion, provided the taxpayer holds the stock for at least five years and submits the certification with the tax return on which the capital gain is reported. In this situation, the revocable trust does not report any gain on the sale of the stock even though the trust has record title to the shares. Instead, the creator of the trust must report the gain on the sale of the stock. The creator of a revocable trust is considered the owner of the shares of stock both for the imposition of the income tax liability and for purposes of the small business stock capital gains exclusion.

**Example 1:** On February 1, 1987, Taxpayer J acquired 100 shares of JKL Corporation stock that qualify as small business stock under sec. 71.01(10), Wis. Stats. During 1991, Taxpayer J contributed the JKL stock to a revocable living trust of which he is the principal beneficiary. Record title to the stock was transferred to Taxpayer J as trustee of the trust. Taxpayer J, as trustee, sold the JKL stock on August 1, 1992.

Taxpayer J may claim the small business stock capital gains exclusion for the gain realized on the sale of the 100 shares of JKL stock, provided he attaches the certification to his tax return. In this situation, the revocable trust does not report any gain on the sale of the stock even though the trust has record title to the shares. Instead, Taxpayer J must report the gain on the sale of the JKL stock on his individual income tax return. Taxpayer J is considered the owner of the shares of stock both for the imposition of the income tax liability and for purposes of the small business stock capital gains exclusion.

**Example 2:** On January 15, 1987, Taxpayer I and his spouse acquired 100 shares of MNO Corporation stock that qualify as small business stock under sec. 71.01(10), Wis. Stats. The stock was acquired as marital property and continues to be classified as marital property. During 1991, they contributed the MNO stock to a revocable living trust created by them for their benefit. Record title to the stock was transferred to Taxpayer I as trustee of the trust. The MNO stock was sold on April 1, 1992.

Taxpayer I and his spouse may claim the small business stock capital gains exclusion for the gain realized on the sale of the 100 shares of MNO stock, provided they attach the certification to their joint or separate tax returns. The revocable trust does not report any gain on the sale of the stock even though the trust has record title to the shares. Taxpayer I and his spouse must report the gain on the sale of the stock as if they had retained record title.

**Question 14:** If a partnership or limited liability company treated as a partnership acquires stock that meets the requirements under sec. 71.01(10), Wis. Stats., may the gain on the sale of the stock qualify for the small business stock capital gains exclusion?

**Answer 14:** If a partnership or limited liability company treated as a partnership holds the small business stock for at least five years, an indi-

vidual or fiduciary who is a partner or member of the entity may qualify for the small business stock capital gains exclusion, provided the partner or member owned an interest in the entity at the time the stock was acquired and the partner or member submits the certification with the tax return on which the capital gain is reported. Since a partnership or limited liability company treated as a partnership is a pass-through entity, items of income, gain, loss, or deduction retain their character when passed through to the partners or members. Therefore, stock that meets the requirements under sec. 71.01(10), Wis. Stats., retains its character as small business stock when gain flows through to the partners or members. However, persons who become partners or members after the stock is acquired do not qualify for the small business stock capital gains exclusion. In addition, corporations that are partners or members do not qualify for the capital gains exclusion.

**Example 1:** FGH Partnership consists of three individuals, Taxpayers F, G, and H, who each have a one-third interest in partnership profits and losses. On March 1, 1993, FGH Partnership acquired 500 shares of stock that qualify as small business stock under sec. 71.01(10), Wis. Stats. FGH Partnership sells the stock on December 31, 1998.

Taxpayers F, G, and H may claim the small business stock capital gains exclusion for their share of the gain realized on the sale of the 500 shares of stock, provided they attach the certification to their individual income tax returns. The gain on the stock retains its character as gain on small business stock when it flows through to Taxpayers F, G, and H.

**Example 2:** CD Partnership consisted of two individuals, Taxpayers C and D, who each had a one-half interest in partnership profits and losses. On August 1, 1993, CD Partnership acquired 400 shares of stock that qualify as small business stock under sec. 71.01(10), Wis. Stats. On

January 1, 1995, CD Partnership admits Taxpayer E, another individual, as a partner with a one-third interest in partnership profits and losses. CDE Partnership sells the stock on March 1, 1999.

Taxpayers C and D may claim the small business stock capital gains exclusion for their share of the gain realized on the sale of the 400 shares of stock, provided they attach the certification to their individual income tax returns. Any gain allocated to Taxpayer E does not qualify for the small business stock capital gains exclusion. □

### 3 Passive Activity Losses Allowable to a Nonresident Individual

**Statutes:** Sections 71.01(13), 71.04(1), and 71.05(6)(a)2, Wis. Stats. (1993-94)

**Background:** Section 469 of the Internal Revenue Code (IRC) limits the deduction of passive activity losses. Generally, passive activities consist of trade or business activities in which the taxpayer does not materially participate during the taxable year and rental activities. Passive activity losses that are not allowed in the current year are carried forward to future years.

The passive activity loss limits also apply for Wisconsin. [Sec. 71.01(13), Wis. Stats. (1993-94).] All income or loss of resident individuals follows the residence of the individual. Income or loss of nonresident individuals follows the situs of the business from which derived. [Sec. 71.04(1)(a), Wis. Stats. (1993-94).]

In addition, losses not allocable to Wisconsin are added to federal adjusted gross income to calculate an individual's Wisconsin taxable income. [Sec. 71.05(6)(a)2, Wis. Stats. (1993-94).]

**Facts and Question 1:** An individual incurs losses from passive activities

for years in which the individual is a Wisconsin resident. Because of the passive activity loss limitations, the losses are not allowed as a deduction on the federal or Wisconsin income tax returns for those years.

The individual subsequently moves from Wisconsin and becomes a resident of another state. The passive activity losses which were incurred while the individual was a Wisconsin resident are carried forward and allowed as a deduction on the individual's federal income tax return for a year in which the individual is a nonresident of Wisconsin.

May the individual deduct the passive activity losses on his or her Wisconsin income tax return for that same year?

**Answer 1:** Yes. Passive activity losses incurred while an individual is a Wisconsin resident may be carried forward and deducted on a Wisconsin income tax return for a year in which the individual is a nonresident of Wisconsin. This is true even though income from the passive activity may no longer be taxable to Wisconsin.

Passive activity losses which are allocable to a Wisconsin resident under sec. 71.04(1)(a), Wis. Stats. (1993-94), retain their status as allocable to Wisconsin when the individual becomes a nonresident. **The passive activity losses are allowed as a deduction on the Wisconsin income tax return for the same year in which they are allowed as a deduction on the federal income tax return.**

**Example:** For 1993 Taxpayer X was a full-year resident of Wisconsin. Taxpayer X became a partner in three partnerships: Partnership A which conducts business solely in Illinois; Partnership B which conducts business solely in Wisconsin; and Partnership C which conducts business in both Wisconsin and Illinois. Taxpayer X determines that he must treat

the partnership interests as passive activities. His unallowed passive activity losses which may be carried forward to 1994 for federal and Wisconsin tax purposes are as follows:

Partnership A (Illinois)	\$6,200
Partnership B (Wisconsin)	\$8,000
Partnership C (Wisconsin and Illinois)	\$5,000.

On January 1, 1994, Taxpayer X became an Illinois resident. For 1994, Taxpayer X has additional passive activity losses of \$600 from Partnership A and \$1,000 from Partnership C of which \$500 is allocated to Wisconsin and \$500 to Illinois. Taxpayer X reported \$800 of income from Partnership B on both his federal and Wisconsin income tax returns and was allowed to deduct \$800 of the prior year unallowed passive activity losses. The unallowed passive activity losses which may be carried forward to 1995 for federal tax purposes are as follows:

Partnership A (Illinois)	\$6,800
Partnership B (Wisconsin)	\$7,200
Partnership C (Wisconsin and Illinois)	\$6,000.

For 1995, Taxpayer X reports passive activity income of \$2,000 from partnership A, \$30,000 from Partnership B, and \$8,000 from Partnership C of which \$5,000 is allocable to Wisconsin. For federal tax purposes, Taxpayer X is allowed to deduct all of the unallowed passive activity losses which were carried forward to 1995.

The amount of income and loss from passive activities which Taxpayer X reports on his 1995 Wisconsin income tax return is as follows:

**Partnership A:** Income from Partnership A, which does business solely in Illinois, is not taxable to Wisconsin. Taxpayer X is allowed to deduct \$6,200 of previously unallowed passive activity loss which was incurred while he was a Wisconsin resident.

**Partnership B:** The income (\$30,000) from Partnership B, which does business solely in Wisconsin, is taxable to Wisconsin. Taxpayer X is allowed to deduct the \$7,200 of previously unallowed passive activity loss which was carried forward to 1995.

**Partnership C:** The portion (\$5,000) of the income from Partnership C which is attributable to business transacted in Wisconsin is taxable to Wisconsin. Taxpayer X is allowed to deduct \$5,500 of the previously unallowed passive losses (\$5,000 from 1993 and \$500 from 1994).

Therefore, the 1995 federal and Wisconsin income tax returns would include the following passive income and losses:

	Federal	Wisconsin
Passive activity income:		
Partnership A	\$ 2,000	\$ - 0 -
Partnership B	30,000	30,000
Partnership C	8,000	5,000
Allowable passive activity losses:		
Partnership A	\$ (6,800)	\$ (6,200)
Partnership B	(7,200)	(7,200)
Partnership C	<u>(6,000)</u>	<u>(5,500)</u>
Total	\$20,000	\$16,100.

**Facts and Question 2:** An individual incurs losses from passive activities for years in which the individual is a nonresident of Wisconsin. The losses are not allocable to Wisconsin under sec. 71.04(1)(a), Wis. Stats. (1993-94). Because of the passive activity loss limitations, the losses are not allowed as a deduction on the federal income tax returns for those years.

The individual subsequently becomes a Wisconsin resident. The passive activity losses which were incurred while the individual was a nonresident of Wisconsin are carried forward and allowed as a deduction on the individual's federal income tax return for a year in which the individual is a Wisconsin resident.

May the individual deduct the passive activity losses on his or her Wisconsin income tax return for that same year?

**Answer 2:** No. Passive activity losses incurred while an individual is a nonresident of Wisconsin and which are not allocable to Wisconsin under sec. 71.04(1)(a), Wis. Stats. (1993-94), may not be carried forward and deducted on a Wisconsin income tax return for a year in which the individual is a Wisconsin resident.

**Example:** Taxpayer Y is a Minnesota resident. He is a partner in Partnership D which conducts business solely in Minnesota. Taxpayer Y determines that he must treat the partnership interest as a passive activity. His unallowed passive activity losses which may be carried forward to 1995 for federal tax purposes are \$12,000.

On January 1, 1995, Taxpayer Y became a Wisconsin resident.

On his 1995 federal income tax return, Taxpayer Y reports passive activity income of \$20,000 from Partnership D. For federal tax purposes, he is allowed to deduct the \$12,000 of unallowed passive activity losses which were carried forward to 1995.

Taxpayer Y must report \$20,000 of income from Partnership D on his 1995 Wisconsin income tax return. He is not allowed to deduct the pre-1995 passive activity losses which were carried forward to 1995. □

## 4 Taxation of Air Carrier Employees

**Statutes:** Section 71.05(6)(b)3, Wis. Stats. (1993-94)

**Note:** With respect to wages an airline employee receives for performing services on behalf of the employee's airline union, this tax release applies only to wages received on or after August 23, 1994.



**Background:** Under federal law (Public Law 96-193, enacted February 15, 1980), the compensation an airline employee receives for performing services on an aircraft may be taxed only in the employee's state of residence and the state in which the employee performs more than 50% of his or her duties. Compensation is defined as "all moneys received for services rendered by the employee in the performance of his duties and shall include wages and salary."

Effective August 23, 1994, federal law was amended (Public Law 103-305) to provide that compensation paid by an airline to an employee in connection with the employee's authorized leave or other authorized absence from regular duties to perform services on behalf of the employee's airline union may be taxed only in the employee's state of residence and the state in which the employee's scheduled flight time would have been more than 50% of the employee's total scheduled flight time for the calendar year had the employee been engaged full time in the performance of regularly assigned duties on the carrier's aircraft.

**Question:** Under what conditions are wages earned by an airline employee subject to Wisconsin tax?

**Answer:** Airline employees are subject to Wisconsin income tax as follows:

- A. *Airline employees who are legal residents of Wisconsin for the entire taxable year* — All wages are subject to Wisconsin income tax.
- B. *Airline employees who are not legal residents of Wisconsin for any portion of the taxable year (i.e., nonresidents for the entire year)* — Wages earned on an aircraft in Wisconsin are subject to Wisconsin income tax only if

the airline employee performs more than 50% of his or her airline duties in Wisconsin in the calendar year. In the case of wages paid by the airline to an employee on authorized leave or other authorized absence from regular duties to perform services on behalf of the employee's airline union in Wisconsin, such wages are taxable to Wisconsin only if the employee's scheduled flight time in Wisconsin would have been more than 50% of the employee's total scheduled flight time for the calendar year had the employee been engaged full time in the performance of regularly assigned duties on the carrier's aircraft.

C. *Airline employees who are legal residents of Wisconsin for a portion of the taxable year (i.e., part-year residents of Wisconsin)* —

1. During the period in which the airline employee is a legal resident of Wisconsin, all wages are subject to Wisconsin income tax.
2. During the period in which the employee is a nonresident of Wisconsin, wages earned on an aircraft in Wisconsin are subject to Wisconsin income tax only if the airline employee performs more than 50% of his or her airline duties in Wisconsin in the calendar year. In the case of wages paid by the airline to an employee on authorized leave or other authorized absence from regular duties to perform services on behalf of the employee's airline union in Wisconsin, during the period in which the employee is a nonresident of Wisconsin such wages are taxable to

Wisconsin only if the employee's scheduled flight time in Wisconsin would have been more than 50% of the employee's total scheduled flight time for the calendar year had the employee been engaged full time in the performance of regularly assigned duties on the carrier's aircraft. □

## 5 Waiver of Interest on Underpayment of Estimated Tax

**Statutes:** Sections 71.09(11)(intro.), (c) and (d) and 71.84(1), Wis. Stats. (1993-94)

**Background:** Under sec. 71.84(1), Wis. Stats. (1993-94), individuals and fiduciaries, except those exempted under sec. 71.09, Wis. Stats. (1993-94), are subject to interest charges of 12% per year on underpayments of estimated tax. Section 71.09(11), Wis. Stats. (1993-94), provides exceptions under which the interest charges do not apply.

Under sec. 71.09(11)(c) and (d), Wis. Stats. (1993-94), the underpayment interest may be waived if the Secretary of Revenue determines that either:

- A. It is not equitable to impose interest because of a casualty, disaster, or other unusual circumstance; or
- B. The taxpayer retired during the taxable year or the preceding taxable year after attaining age 62 or becoming disabled, and the underpayment was due to reasonable cause rather than willful neglect.

The procedures for applying for a waiver of underpayment interest can

be found in the instructions for completing Wisconsin Schedule U, "Underpayment of Estimated Tax by Individuals and Fiduciaries." Upon application for a waiver by the taxpayer, the department will consider each case on its own merits. The number of quarterly installments for which the department will waive the interest and the amount of interest to be waived will be determined based on the circumstances of each case.

**Question 1:** What are some situations in which interest may be waived under the "casualty, disaster, or other unusual circumstances" provision?

**Answer 1:** Under this provision, all or a portion of the interest on estimated tax underpayments may be waived if any of the following events has occurred:

- A. The taxpayer was involved in a natural disaster, such as a fire, a flood, or a tornado.
- B. The taxpayer or an immediate family member suffered a debilitating illness, such as a heart attack, a stroke, or cancer, or an injury (for example, due to an auto accident).
- C. The taxpayer entered a nursing home or other treatment facility.
- D. The taxpayer requested an employer to withhold Wisconsin tax, but the employer withheld another state's tax.
- E. The taxpayer began working in a state with which Wisconsin has reciprocity (Illinois, Indiana, Kentucky, Michigan, or Minnesota), and the employer withheld tax of the reciprocal state rather than Wisconsin tax.
- F. The taxpayer moved to Wisconsin from a reciprocal state, and the employer continued to with-

hold tax of the reciprocal state rather than Wisconsin tax.

- G. The taxpayer or the taxpayer's spouse died.

**Question 2:** What are some situations in which interest may be waived under the "retirement and reasonable cause" provision?

**Answer 2:** Under this provision, the taxpayer must have retired during the taxable year or the preceding taxable year; prior to retirement the taxpayer must have become disabled or reached age 62; and the underpayment must have been due to reasonable cause rather than willful neglect. The taxpayer's retirement is not in itself considered "reasonable cause."

If the taxpayer meets the "retirement" provision outlined above, all or a portion of the interest may be waived in the following "reasonable cause" situations:

- A. For the preceding year, the taxpayer did not make estimated tax payments, was not assessed underpayment interest, and was not granted an underpayment interest waiver.
- B. The taxpayer erroneously thought Wisconsin tax was being withheld from retirement income because federal tax was withheld.
- C. The taxpayer received incorrect information from the employer or other payer about the taxability of retirement income.
- D. The taxpayer suffered a disabling illness or injury that led to retirement.

**Question 3:** What are some situations in which interest on an estimated tax underpayment will not be waived?

**Answer 3:** The department considers each application for waiver separately. It will not waive interest on an underpayment of estimated tax based solely on any of the following criteria:

- A. The taxpayer was not aware of the estimated tax payment requirements.
- B. The taxpayer was away on vacation or business when the payments were due.
- C. The taxpayer willfully neglected to make the payments. ☐

## INDIVIDUAL INCOME AND CORPORATION FRANCHISE AND INCOME TAXES

### 6 Franchise or Income Tax Nexus — Effect of Intangibles in Wisconsin

**Statutes:** Sections 71.02(1) and 71.23(1) and (2), Wis. Stats. (1993-94)

**Wis. Adm. Code:** Section Tax 2.82, November 1993 Register

#### I. Introduction

This tax release describes how the presence of various types of intangibles in Wisconsin may create nexus for Wisconsin income or franchise tax purposes. This tax release applies to all types of taxpayers (i.e. individuals, partnerships, corporations, estates, and trusts).

#### II. Background

The licensing (as licensor) of intangible rights for use in Wisconsin is a nexus creating activity pursuant to sec. Tax 2.82(4)(a) 9, Wis. Adm. Code.

The July 6, 1993 South Carolina Supreme Court decision (No. 23886) in *Geoffrey, Inc. v. South Carolina Tax Commission*, determined the licensing of intangibles (trademarks, trade names, and merchandising techniques) to a South Carolina retailer, by a foreign corporation with no other activity in South Carolina, created income tax nexus. The South Carolina Supreme Court found that Geoffrey's receipt of royalty income from licensing the trademarks and trade names satisfied the Due Process Clause of the U.S. Constitution because Geoffrey purposefully directed its activity toward South Carolina, a finding consistent with the U.S. Supreme Court decision in *Quill Corp. v. North Dakota*, 504 US \_\_\_\_ (1992).

The South Carolina Supreme Court also ruled that the presence of Geoffrey's intangibles in South Carolina, along with Geoffrey's receipt of royalty income from their use in South Carolina, satisfied the Commerce Clause of the U.S. Constitution because they represented a "substantial nexus" with the state. Geoffrey requested the U.S. Supreme Court to review the South Carolina Supreme Court decision. However, the U.S. Supreme Court denied their request on November 29, 1993, Docket No. 93- 520.

It has been determined that the mere presence alone of tangible personal property in a state does not create a franchise tax filing requirement in every instance, (*Wisconsin Dept. of Revenue v. Amerco Lease Company*, Wis. Tax Rep. (CCH) Par 202-952 (1987), and *Dept. of Taxation v. Blatz Brewing Company*, 12 Wis. 2d 615 (1961)). However, the intangibles listed in this tax release are distinguished from those cases because each example reflects more than a passive ownership of property in Wisconsin, which passive ownership was determined not to constitute

"doing business" by *Amerco* and *Blatz*. Therefore, the mere presence alone of a taxpayer's intangible property in Wisconsin is not in itself sufficient to create nexus. However, the presence of intangibles in Wisconsin may create nexus for Wisconsin income or franchise tax purposes if **all three** of the following conditions are met:

1. The property or service (source of income) to which the intangible pertains must be present in Wisconsin. For example, in *Geoffrey*, Toys R Us stores were present in South Carolina.
2. The taxpayer must be involved in the licensing of the intangible in Wisconsin in the course of an income producing business activity. According to *Geoffrey*, it was determined that, "By licensing intangibles which could be used in South Carolina and receiving income in exchange for their use, the taxpayer had the minimum connection with the state necessary for the imposition of income tax."
3. The licensing of the intangible must be substantial, as required by the U.S. Commerce Clause, rather than de minimus.

### III. Definitions

For purposes of this tax release, the following definitions apply:

**Income Producing Activity** — sec. Tax 2.39(6)(c)3, Wis. Adm. Code — the act or acts directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profit. Income producing activity includes but is not limited to the sale, licensing the use of, or other use of intangible personal property, such as patents, copyrights, trademarks, and trade names.

**Intangibles** — property that is a "right," such as a patent, copyright,

or trademark, or one which is lacking physical existence, such as goodwill.

**Intangible Property** — property that has no intrinsic and marketable value, but is merely the representative or evidence of value, such as certificates of stock, bonds, promissory notes, copyrights, and franchises.

**Lease** — to transfer for term specified therein from lessor to lessee property therein demised, and an agreement under which owner gives up possession and use of property for valuable consideration and for definite term.

**License** — permission to do a particular thing, to exercise a certain privilege, to carry on a particular business, or to pursue a certain occupation.

### IV. Examples of Intangibles

The following examples describe when the presence of various types of intangibles in Wisconsin may create nexus for Wisconsin income or franchise tax purposes. In each example it is assumed the taxpayer has no other nexus creating activity in Wisconsin. This list of examples is not meant to be all-inclusive.

#### *Type of Intangible:*

**Example 1. Copyright:** Bookmark Inc., a New York corporation, is in the business of licensing copyrights. Bookmark Inc. licenses copyrights to Press Inc., a Wisconsin publisher. Bookmark Inc. receives a specific amount per book from Press Inc. as a result of the copyrights licensed.

Bookmark Inc. has Wisconsin franchise or income tax nexus.

**Example 2. Custom Software:** Comp. Design Inc., a Missouri corporation, is in the business of licensing custom software. Comp. Design

Inc. enters into custom software licensing agreements with Wisconsin companies who sell the software packages to other Wisconsin customers. Comp. Design Inc. receives 1% of each sale to a Wisconsin customer under its licensing agreements.

Comp. Design Inc. has Wisconsin franchise or income tax nexus.

**Example 3. Franchise:** Taxpayer A, a resident of Iowa in the business of franchising corndog stands, grants Taxpayer B, a resident of Wisconsin, a franchise which allows Taxpayer B to sell corndogs under the name of Taxpayer A at a specified location in Wisconsin. Taxpayer A receives a percentage of Taxpayer B's sales of corndogs.

Taxpayer A has Wisconsin franchise or income tax nexus.

**Example 4. Operating Permit:** MST, a Missouri corporation, owns several operating permits to transport several types of property in Wisconsin and a number of other midwest states. MST conducts some transportation business of its own outside Wisconsin, but also offers to lease the operating permits for Wisconsin to anyone wishing to transport the types of property covered by the Wisconsin permits. A Wisconsin transportation firm leases one of the Wisconsin operating permits from MST, paying MST a specified amount for each mile traveled in Wisconsin under the permit.

MST has Wisconsin franchise or income tax nexus.

**Example 5. Patent Right:** JCN, a New York corporation, owns patent rights to various processes in a manufacturing system. JCN licenses these rights to manufacturers for use in the manufacture of products, and licenses the right to use one of the processes to a Wisconsin manufacturer. JCN

receives a specific amount for each item manufactured in Wisconsin under its patent.

JCN has Wisconsin franchise or income tax nexus.

**Example 6. Sanction:** TTN, a Wyoming firm, represents a group of cowboys who perform in rodeos. As part of its regular company policy, TTN sanctions rodeos. RYD, a Wisconsin company, is planning a rodeo for local residents. RYD pays TTN a fee to sanction the rodeo based on a specific amount per each person attending the rodeo.

TTN has Wisconsin franchise or income tax nexus.

**Example 7. Territorial Right:** Washmaster Inc., an Illinois corporation, receives exclusive territorial rights from Ridgeview Inc., also an Illinois corporation, to sell washers and dryers in 24 southern Wisconsin counties. Washmaster Inc. later licenses territorial rights to 12 of the counties to Speedmatic Inc., a Wisconsin corporation. The terms of the license provide that 2% be paid to Washmaster Inc. on all of the sales made by Speedmatic Inc.

Washmaster Inc. has Wisconsin franchise or income tax nexus.

**Example 8. Trade Name:** TN, a Missouri corporation in the business of licensing trade names for hair care products, grants Hair By Hare, a Wisconsin shampoo manufacturer, a license to use TN's trade name on its bottles of shampoo. TN receives a percentage of sales of all shampoo sold by Hair By Hare.

TN has Wisconsin franchise or income tax nexus.

**Example 9. Trade Secret:** TS Inc., a Texas corporation, purchases recipes for cookies from various individ-

uals throughout the United States and licenses the use of the recipes, as trade secrets, to a Wisconsin bakery. The Wisconsin bakery uses the recipes in the production of its cookies and pays TS Inc. a specific amount per dozen cookies produced.

TS Inc. has Wisconsin franchise or income tax nexus.

**Example 10. Trademark:** TM Inc., an Arizona corporation, owns the trademark to a line of paper products. TM Inc. licenses the use of the trademark to the Wisconsin manufacturer of the paper goods. The Wisconsin manufacturer pays a 1% license fee to TM Inc. on all TM Inc. products sold.

TM Inc. has Wisconsin franchise or income tax nexus.

**Example 11. Membership:** ISC, a Florida corporation, owns memberships in several information network systems located outside Wisconsin. ISC leases one of the memberships to TEC, a Wisconsin company. TEC pays ISC a specific amount for each minute it uses the information network.

ISC has Wisconsin franchise or income tax nexus. ☐

## SALES AND USE TAXES

**Note:** The following tax releases interpret the Wisconsin sales and use tax law as it applies to the 5% state sales and use tax. The ½% county sales and use tax may also apply. For information on sales or purchases that are subject to the county sales and use tax, refer to the January 1995 issue of the *Sales and Use Tax Report*. A copy can be found in *Wisconsin Tax Bulletin* 90 (January 1995), pages 39 to 42.

## 7 Nonprofit Organization's Sales — Admission Event Involves Entertainment

**Statutes:** Sections 77.52(2)(a)2 and 77.54(7m), Wis. Stats. (1993-94)

**Wis. Adm. Code:** Section Tax 11.35(6)(a), June 1991 Register

**Background:** Section 77.54(7m), Wis. Stats. (1993-94), provides an exemption from Wisconsin sales or use tax for:

“Occasional sales of tangible personal property or services, including but not limited to admissions or tickets to an event; by a neighborhood association, church, civic group, garden club, social club or similar nonprofit organization; not involving entertainment for which payment in the aggregate exceeds \$300 for performing or as reimbursement of expenses unless access to the event may be obtained without payment of a direct or indirect admission fee conducted by the organization if the organization is not engaged in a trade or business and is not required to have a seller's permit. For purposes of this subsection, an organization is engaged in a trade or business and is required to have a seller's permit if its sales of tangible personal property and services, not including sales of tickets to events, and its events occur on more than 20 days during the year, unless its receipts do not exceed \$15,000 during the year.”

Section Tax 11.35(6)(a), Wis. Adm. Code, provides that to qualify as an exempt occasional sale, entertainment shall not be involved at an event for which charges constitute admissions.

**Facts and Question 1:** Nonprofit Organization A holds a fair. Nonprofit Organization A charges an admission to enter the fair. Upon admission

to the fair, a person may view animal and product exhibits, attend animal shows, and enjoy various musical and comedy performances. Nonprofit Organization A has paid more than \$300 to persons providing musical and comedy performances.

Nonprofit Organization A allows Nonprofit Organization B, a separate entity, to set up a booth at the fair. From its booth, Nonprofit Organization B sells soft drinks and popcorn for consumption on the premises of the fair. Persons will only have access to Nonprofit Organization B's booth upon paying the admission to the fair. Nonprofit Organization B does not receive any of the admission receipts from the fair and does not pay any amount for the entertainment provided at the fair.

For the calendar year in which this fair is held, Nonprofit Organization B will have taxable receipts from sales of tangible personal property and services of \$15,000 or less. Nonprofit Organization B does not hold a Wisconsin seller's permit.

Are Nonprofit Organization A's gross receipts from the sale of admissions to the fair exempt from Wisconsin sales tax as occasional sales under sec. 77.54(7m), Wis. Stats. (1993-94)?

**Answer 1:** No. Since Nonprofit Organization A is charging admission to enter the fair and Nonprofit Organization A pays more than \$300 for the entertainment at the fair, the gross receipts from the admission to the fair do not qualify as exempt occasional sales under sec. 77.54(7m), Wis. Stats. (1993-94). The admissions to the fair are subject to Wisconsin sales tax under sec. 77.52(2)(a)2, Wis. Stats. (1993-94).

**Facts and Question 2:** Assume the same facts as in Facts and Question 1.

Are Nonprofit Organization B's gross receipts from the sale of soft drinks and popcorn at the fair exempt from Wisconsin sales tax as occasional sales under sec. 77.54(7m), Wis. Stats. (1993-94)?

**Answer 2:** Yes. The sales of soft drinks and popcorn by Nonprofit Organization B at the fair qualify as exempt occasional sales under sec. 77.54(7m), Wis. Stats. (1993-94) because:

1. The admission charge is to an event involving entertainment (for which payment exceeds \$300) which is conducted by Nonprofit Organization A, **not** Nonprofit Organization B,
2. Nonprofit Organization B is not “engaged in a trade or business” because its taxable gross receipts for the calendar year are \$15,000 or less, and
3. Nonprofit Organization B does not hold and is not required to hold a Wisconsin seller's permit.

**Facts and Question 3:** Assume the same facts as Facts and Question 1, except that Nonprofit Organization B receives 20% of the admission receipts to the fair and pays 20% of the cost for entertainment at the fair.

Are Nonprofit Organization B's gross receipts from the sale of soft drinks and popcorn at the fair exempt from Wisconsin sales tax as occasional sales under sec. 77.54(7m), Wis. Stats. (1993-94)?

**Answer 3:** No. The sales of soft drinks and popcorn by Nonprofit Organization B do not qualify as exempt occasional sales because they are sold at an event conducted by both Nonprofit Organization A **and** Nonprofit Organization B for which admission is charged and entertainment is provided at a cost exceeding

\$300. Nonprofit Organization B is considered to be conducting the event with Nonprofit Organization A since it shares in the admission receipts from the event.

**Facts and Question 4:** Company A, a for-profit company, owns a basketball team franchise. Company A charges an admission to enter the arena and watch a basketball game on a Saturday. The basketball team is paid a salary, exceeding \$300, to play on Saturday.

Company A allows Nonprofit Organization B, a separate entity, to sell soft drinks and popcorn for consumption on the premises of the arena. Persons have access to Nonprofit Organization B's concession stand upon paying the admission to the arena.

For the calendar year in which this basketball game takes place, Nonprofit Organization B will have taxable receipts from sales of tangible personal property and services of \$15,000 or less. Nonprofit Organization B does not hold a seller's permit.

Are Nonprofit Organization B's gross receipts from the sale of soft drinks and popcorn at arena exempt from Wisconsin sales tax as occasional sales under sec. 77.54(7m), Wis. Stats. (1993-94)?

**Answer 4:** Yes. The sales of soft drinks and popcorn by Nonprofit Organization B at the arena qualify as exempt occasional sales because:

1. The admission charge is to an event involving entertainment (for which payment exceeds \$300) which is conducted by Company A, **not** Nonprofit Organization B,
2. Nonprofit Organization B is not "engaged in a trade or business" because its taxable gross receipts for the calendar year are \$15,000 or less, and

3. Nonprofit Organization B does not hold and is not required to hold a Wisconsin seller's permit. ☐

## 8 Transitional Provisions for Repeal of "Central Office Equipment" Exemption

**Statutes:** Sections 77.51(14r) and 77.54(18), Wis. Stats. (1993-94) and sec. 77.54(24), Wis. Stats. (1993-94), as repealed by 1995 Wisconsin Act 27

**Background:** Effective September 1, 1995, the exemption under sec. 77.54(24), Wis. Stats. (1993-94), relating to apparatus, equipment, and electrical instruments in central offices of telephone companies used in transmitting traffic and operating signals (hereafter "sub. (24) equipment"), is repealed.

Section 77.54(18), Wis. Stats. (1993-94), provides that when the sale, lease, or rental of a service or property that was previously exempt or not taxable for sales and use tax purposes becomes taxable, and the service or property is furnished under a written contract by which the seller is unconditionally obligated to provide the service or property for the amount fixed under the contract, the seller is exempt from sales or use tax on the gross receipts for services or property provided until the contract is terminated, extended, renewed, or modified. However, from the time the service or property becomes taxable until the written contract is terminated, extended, renewed, or modified, the user is subject to use tax, measured by the sales price, on the service or property purchased under the contract.

**Question 1:** When does the sale of sub. (24) equipment take place?

**Answer 1:** Under sec. 77.51(14r), Wis. Stats. (1993-94), the sale of sub.

(24) equipment takes place when possession of the equipment transfers from the seller or the seller's agent to the buyer or the buyer's agent. A common carrier and the U.S. Postal Service are deemed agents of the seller.

**Note:** If the purchase includes installation by the vendor, possession may not transfer until the installation is completed. (*Wisconsin Power & Light Co. v. Wisconsin Department of Revenue*, 11/27/84, CCH 202-482).

**Example 1:** Company A ordered sub. (24) equipment on August 1, 1995, from Company B. The sub. (24) equipment was delivered by common carrier to Company A on August 15, 1995. The exemption for sub. (24) equipment applies since the equipment was "sold" before September 1, 1995 (when the common carrier delivered the equipment to Company A).

**Example 2:** Assume the same facts as Example 1 except that the sub. (24) equipment is not delivered to Company A until October 1, 1995. The exemption for sub. (24) equipment does not apply to the sale of the sub. (24) equipment because the equipment was "sold" after September 1, 1995 (when the common carrier delivered the equipment to Company A).

**Question 2:** Who is responsible for the tax on sub. (24) equipment purchased under a written contract dated prior to September 1, 1995, but sold on or after September 1, 1995?

**Answer 2:** For written contracts to purchase sub. (24) equipment entered into prior to September 1, 1995, that the seller is obligated to furnish for a fixed amount under the written contract, a seller is exempt from Wisconsin sales or use tax on the sale of such equipment occurring on or after September 1, 1995, unless the written contract is modified, extended, or renewed by either party on or after September 1, 1995 but prior to the sale of the equipment. (sec. 77.54(18), Wis. Stats. (1993-94).)

The purchaser of the sub. (24) equipment is subject to Wisconsin use tax on the sales price of the sub. (24) equipment if:

- A. The purchaser took possession of the equipment on or after September 1, 1995, and
- B. The written contract was not modified, renewed, or extended by either party on or after September 1, 1995, and prior to the sale of the equipment.

**Example 1:** Company A entered into a written contract with Company B to purchase sub. (24) equipment on August 1, 1995. Delivery of the property by common carrier to Company A takes place on October 1, 1995. Company A does not modify, extend, or renew the written contract. Company B is not subject to Wisconsin sales tax on the sale of the sub. (24) equipment to Company A. However, Company A is subject to Wisconsin use tax on its purchase of the sub. (24) equipment.

**Example 2:** Assume the same facts as Example 1, except that Company B modifies the written contract on September 15, 1995. Company B is subject to Wisconsin sales tax on the sale of the sub. (24) equipment to Company A because Company B modified the written contract on or after September 1, 1995, but prior to the sale of the equipment to Company A. ☐

## 9 Well Inspection and Water Testing

**Statutes:** Sections 77.51(2) and (20) and 77.52(2)(a)10, Wis. Stats. (1993-94)

**Wis. Adm. Code:** Sections Tax 11.67, November 1993 Register, and Tax 11.68, April 1994 Register

**Background:** Section 77.52(2)(a)10, Wis. Stats. (1993-94), provides that the charge for the repair, service, alteration, fitting, cleaning, painting, coating, towing, inspection, and maintenance of tangible personal property is subject to Wisconsin sales or use tax.

Section Tax 11.68(4)(b), Wis. Adm. Code, provides that certain types of property have a variety of functions that may be personal property in some instances and additions to real property in others. When the property is installed primarily to provide service to a building or structure and is essential to the use of the building or structure, it is a real property improvement. However, when similar property is installed to perform a processing function, it may retain its status as personal property.

Section Tax 11.67(3)(e)1, Wis. Adm. Code, provides that the development of information pursuant to a contract is a sale of a service that is not subject to Wisconsin sales tax. Although the person performing the service may be under contract to provide such things as plans, designs, and specifications, or to test and evaluate a proposed product, the primary objective of the customer is to obtain the results of the technical skill of the researcher.

**Facts and Question 1:** Company A is hired to inspect and repair (if needed) a well for structural integrity and safety.

Is the charge by Company A subject to Wisconsin sales or use tax?

**Answer 1:** No. The charge by Company A for inspecting and servicing a well is not subject to Wisconsin sales or use tax. The well is real property. However, Company A is subject to

Wisconsin sales or use tax on the purchase of any supplies or materials it uses in the inspection or servicing of the well.

**Facts and Question 2:** Company A sends a sample of well water to a laboratory for testing.

Is the charge by the laboratory to Company A subject to Wisconsin sales or use tax?

**Answer 2:** No. The laboratory is providing a testing service which is not a service subject to tax under section 77.52(2)(a)10, Wis. Stats. (1993-94).

**Facts and Question 3:** A customer hires Company B to inspect and repair (if needed) a water pump attached to a well.

Is the charge by Company B subject to Wisconsin sales or use tax?

**Answer 3:** Yes. Company B is inspecting and/or servicing tangible personal property which is a service taxable under sec. 77.52(2)(a)10, Wis. Stats. (1993-94). Section 77.52(2)(a)10, Wis. Stats. (1993-94), provides that certain property, including a water pump, retains its character as tangible personal property after installation for purposes of inspection or repair.

Company B can purchase the replacement parts it transfers to its customer, without tax as property for resale, provided it gives its supplier a properly completed resale certificate. However, Company B is subject to sales or use tax on the purchase of supplies used in the inspection or servicing of the water pump (e.g., rags, cleaners, etc.) which are not physically transferred to its customer. ☐



## 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:

### Corporation Franchise and Income Taxes

Reorganizations — 1987 and thereafter  
W9524005 (p. 40)

### Sales and Use Taxes

Exempt organizations' purchases — out-of-state organizations  
Occasional sales — nonprofit organizations  
W9531007 (p. 42)

Telecommunication services — prepaid telephone calling cards  
W9526006 (p. 44)

✱ **W9524005**, March 24, 1995

**Type Tax:** Corporation Franchise and Income

**Issue:** Reorganizations — 1987 and thereafter

**Statutes:** Sections 71.22(4) and 71.26(2) and (3), Wis. Stats. (1993-94)

This letter is in response to your request for a private letter ruling with respect to the Wisconsin franchise or income tax consequences of a proposed transaction under sections 368(a)(1)(D) and 355 of the Internal Revenue Code (IRC).

### Facts

Corporation A is an accrual basis Wisconsin holding company filing consolidated federal income tax returns on a calendar year basis. Corporation A is the common parent of an affiliated group of corporations which includes, among others, Corporation B, a first-tier holding company, which holds all of the stock of Association D ("Distributing").

Distributing is an accrual basis national banking association headquartered in Wisconsin, subject to regulatory authority by the Office of the Comptroller (OCC). Distributing is engaged in the banking business and in the credit card business.

Corporation A, Corporation B, and Distributing each files a separate Wisconsin corporation franchise tax return.

The banking business includes the receipt of deposits, the granting of all types of loans (including business and

consumer loans), together with the offering of various financial services offered by regulated financial institutions. The credit card business involves the issuing of nationally accepted credit cards together with the credit evaluation, collection, and other systems necessary to support that activity. It also involves the solicitation of merchants to accept these credit cards from their customers, and services necessary to provide support to those merchants.

The following transactions are proposed:

- (1) Distributing will transfer the assets of the credit card business, subject to liabilities, to Association C ("Controlled"), a newly formed national banking association headquartered in Illinois, in exchange for all of the shares of the only class of stock of Controlled.
- (2) Distributing will distribute all of the stock owned by Distributing in Controlled to its sole shareholder, Corporation B.

The business purpose of the transaction is to enable the credit card business to compete more effectively with other national credit card businesses. The state in which Controlled will be headquartered has laws similar to those available in states in which other national credit card issuers are located. Federal law prohibits Distributing from owning a controlling interest in another bank. Therefore, in order to achieve the desired purpose, it is necessary to spin off Controlled to Corporation B, a bank holding company which is allowed to hold the stock of banks.



## Request

You have requested that the following rulings be issued:

1. If the transfer by Distributing to Controlled of the credit card business solely in exchange for all of the stock of Controlled and the assumption of certain liabilities, followed by the distribution of the Controlled stock to Corporation B, qualifies as a reorganization within the meaning of IRC sec. 368(a)(1)(D) and Distributing and Controlled each qualifies as "a party to a reorganization" within the meaning of IRC sec. 368(b) for federal income tax purposes, IRC sec. 368(a)(1)(D) and (b) will also apply for Wisconsin franchise or income tax purposes.
2. If no gain or loss is recognized to Distributing upon the transfer of assets, subject to liabilities, to Controlled in exchange for Controlled stock under IRC secs. 361(a) and 357(a) for federal income tax purposes, IRC secs. 361(a) and 357(a) will also apply for Wisconsin franchise or income tax purposes.
3. If no gain or loss is recognized to Controlled on the receipt of the assets in exchange for Controlled stock, under IRC sec. 1032(a), for federal income tax purposes, IRC sec. 1032(a) will apply for Wisconsin franchise or income tax purposes.
4. If the basis of the assets received by Controlled is the same as the basis of such assets in the hands of Distributing immediately prior to the transaction described above under IRC sec. 362(b) for federal income tax purposes, IRC sec. 362(b) will also apply to their Wisconsin tax bases.
5. If the holding period of the Distributing assets received by Controlled includes the period during which such assets were held by Distributing under IRC sec. 1223(2) for federal income tax purposes, IRC sec. 1223(2) will also apply for Wisconsin franchise or income tax purposes.
6. If no gain or loss is recognized by, and no amount is included in the income of, Distributing upon the distribution of all its stock in Controlled to Corporation B under IRC sec. 361(c) for federal income tax purposes, IRC sec. 361(c) will also apply for Wisconsin franchise or income tax purposes.
7. If no gain or loss is recognized by, and no amount is included in the income of, Corporation B upon the receipt of Controlled stock under IRC sec. 355(a)(1) for federal income tax purposes, IRC sec. 355(a)(1) will also apply for Wisconsin franchise or income tax purposes.
8. If the basis of the stock of Controlled and Distributing in the hands of Corporation B after the distribution is, in each instance, the same as the aggregate basis of the Distributing stock held immediately before the distribution, allocated in proportion to the fair market value of each, in accordance with sec. 1.358-2(a)(2) of the Income Tax Regulations under IRC sec. 358(a) and (b)(1) for federal income tax purposes, that same treatment will apply for Wisconsin franchise or income tax purposes.
9. If the holding period of the Controlled stock received by Corporation B includes the holding period of the Distributing stock with respect to which the distribution will be made, provided that the Distributing stock is held as a capital asset on the date of the exchange, under IRC sec. 1223(1) for federal income tax purposes, IRC sec. 1223(1) will also apply for Wisconsin franchise or income tax purposes.
10. If, as provided in IRC sec. 312(h), proper allocation of earnings and profits between Distributing and Controlled is made under sec. 1.312-10(a) of the Income Tax Regulations for federal income tax purposes, IRC sec. 312(h) will also apply for Wisconsin income tax purposes.

## Ruling

1. If the transfer by Distributing to Controlled of the credit card business solely in exchange for all of the stock of Controlled and the assumption of certain liabilities, followed by the distribution of the Controlled stock to Corporation B, qualifies as a reorganization within the meaning of IRC sec. 368(a)(1)(D) and Distributing and Controlled each qualifies as "a party to a reorganization" within the meaning of IRC sec. 368(b) for federal income tax purposes, IRC sec. 368(a)(1)(D) and (b) will also apply for Wisconsin franchise or income tax purposes.
2. If no gain or loss is recognized to Distributing upon the transfer of assets, subject to liabilities, to Controlled in exchange for Controlled stock under IRC secs. 361(a) and 357(a) for federal income tax purposes, IRC secs. 361(a) and 357(a) will also apply for Wisconsin franchise or income tax purposes.
3. If no gain or loss is recognized to Controlled on the receipt of the assets in exchange for Controlled stock, under IRC sec.

1032(a), for federal income tax purposes, IRC sec. 1032(a) will apply for Wisconsin franchise or income tax purposes.

4. If the basis of the assets received by Controlled is the same as the basis of such assets in the hands of Distributing immediately prior to the transaction described above under IRC sec. 362(b) for federal income tax purposes, IRC sec. 362(b) will also apply to their Wisconsin tax bases.
5. If the holding period of the Distributing assets received by Controlled includes the period during which such assets were held by Distributing under IRC sec. 1223(2) for federal income tax purposes, IRC sec. 1223(2) will also apply for Wisconsin franchise or income tax purposes.
6. If no gain or loss is recognized by, and no amount is included in the income of, Distributing upon the distribution of all its stock in Controlled to Corporation B under IRC sec. 361(c) for federal income tax purposes, IRC sec. 361(c) will also apply for Wisconsin franchise or income tax purposes.
7. If no gain or loss is recognized by, and no amount is included in the income of, Corporation B upon the receipt of Controlled stock under IRC sec. 355(a)(1) for federal income tax purposes, IRC sec. 355(a)(1) will also apply for Wisconsin franchise or income tax purposes.
8. If the basis of the stock of Controlled and Distributing in the hands of Corporation B after the distribution is, in each instance, the same as the aggregate basis of the Distributing stock held immediately before the distribu-

tion, allocated in proportion to the fair market value of each, in accordance with sec. 1.358-2(a)(2) of the Income Tax Regulations under IRC sec. 358(a) and (b)(1) for federal income tax purposes, that same treatment will apply for Wisconsin franchise or income tax purposes.

9. If the holding period of the Controlled stock received by Corporation B includes the holding period of the Distributing stock with respect to which the distribution will be made, provided that the Distributing stock is held as a capital asset on the date of the exchange, under IRC sec. 1223(1) for federal income tax purposes, IRC sec. 1223(1) will also apply for Wisconsin franchise or income tax purposes.
10. If, as provided in IRC sec. 312(h), proper allocation of earnings and profits between Distributing and Controlled is made under sec. 1.312-10(a) of the Income Tax Regulations for federal income tax purposes, IRC sec. 312(h) will also apply for Wisconsin income tax purposes.

#### Analysis

The Wisconsin net income of a corporation is determined under the Internal Revenue Code, as defined in sec. 71.22(4), Wis. Stats. (1993-94), with certain modifications. Internal Revenue Code secs. 312, 355, 357, 358, 361, 362, 368, 1032, and 1223 are not excluded from the Internal Revenue Code in effect for Wisconsin purposes, nor are these Code sections modified in sec. 71.26(3), Wis. Stats. (1993-94). Therefore, these Internal Revenue Code sections will apply to the three separate Wisconsin taxpayers involved in the reorganization. □

✴ **W9531007**, May 12, 1995

**Type Tax:** Sales and Use

**Issue:** Exempt organizations' purchases — out-of-state organizations; Occasional sales — nonprofit organizations

**Statutes:** Section 77.54(7m) and (9a)(f), Wis. Stats. (1993-94)

**Wis. Adm. Code:** Sections Tax 11.14 (March 1991 Register), Tax 11.35 (June 1991 Register), Tax 11.67 (November 1993 Register), and Tax 11.87 (December 1992 Register)

This letter responds to your request for a private letter ruling regarding the Wisconsin sales and use tax implications relating to purchases of meals at the Organization NP forum, and sales of materials, club supplies and clothing at this event.

#### Facts

Organization NP (the organization) is a nonprofit organization incorporated under a nonprofit Act of another state. The organization is organized and operated exclusively to further and support charitable, educational and scientific purposes. The organization does not hold a Wisconsin seller's permit, nor does it hold a Wisconsin Certificate of Exempt Status.

The organization, as part of its mission, is sponsoring educational seminars (the forum) in Wisconsin in 1996. The organization will hire motivational and educational speakers for the forum. Speakers at the forum will include both volunteers and professionals.

Attendees pay a fee of \$110 to \$140 for registration, which includes three or four meals. The organization also sells various club supplies provided

by its parent organization and clothing articles identified with the organization's logo. The club supplies and clothing articles are available only to persons who are registered for the forum. The organization's sales of club supplies and clothing articles would approximate \$50,000 over a single three-day period.

The organization provides service club members with this educational opportunity just once a year and each year it is in a different state or province. The organization does not make any sales of tangible personal property or taxable services in Wisconsin, other than those sales described above.

### Ruling Request

1. Are the organization's purchases of meals and other items in Wisconsin while presenting its forum subject to sales tax?
2. Is the organization required to register as a retailer in Wisconsin and collect sales tax on its sales of club supplies and clothing articles to attendees at the event?

### Ruling

1. The organization's purchases of meals in Wisconsin are exempt from Wisconsin sales and use tax, provided that (a) the retailer of the meals issues the billings or invoices in the organization's name, and (b) the organization provides a certificate of exemption, Form S-207, to the retailer. The organization may purchase the club supplies and clothing which it will resell at the forum exempt from Wisconsin sales and use tax by providing its suppliers with properly completed resale certificates, Form S-205.
2. The organization is not required to register as a retailer in Wisconsin and collect sales tax on its

sales of club supplies and clothing articles to attendees at the forum. (This answer assumes that the forum does not involve entertainment for which payment in the aggregate exceeds \$300 for performing or reimbursement of expenses.)

### Analysis

#### 1. Sales to Organization

Section 77.54(9a)(intro.) and (f), Wis. Stats. (1993-94), provides an exemption from Wisconsin sales and use tax for "The gross receipts from sales to, and the storage by, use by or other consumption of tangible personal property and taxable services by ... Any corporation, community chest fund, foundation or association organized and operated exclusively for religious, charitable, scientific or educational purposes ... no part of the net income of which inures to the benefit of any private stockholder, shareholder, member or corporation."

Section Tax 11.67(1), Wis. Adm. Code, November 1993 Register, provides that when a transaction involves the transfer of tangible personal property along with the performance of a service, the true objective of the purchaser determines whether the transaction is a sale of tangible personal property or the performance of a service with the transfer of property being merely incidental to the performance of the service.

Because the objective of the attendees at the forum is to attend the educational seminars, the organization is considered the consumer of and not a reseller of the meals provided at the forum. Because the organization is organized and operated exclusively to further and support charitable,

educational and scientific purposes, the organization's purchases are exempt from Wisconsin sales and use tax under sec. 77.54(9a)(f), Wis. Stats. (1993-94).

Section Tax 11.87(2)(k)3, Wis. Adm. Code, December 1992 Register, provides that sales of food and beverages to an exempt organization are not subject to tax provided all of the following conditions are met:

- a. The retailer issues the billing or invoice for the food and beverages in the name of the exempt organization.
- b. The Certificate of Exempt Status number of the exempt organization is entered on the retailer's copy of the billing or invoice.
- c. The retailer keeps a copy of the documents described in conditions a. and b. above.

Because the organization is located outside Wisconsin and does not hold a Wisconsin Certificate of Exempt Status, it may provide the retailer of the meals with a properly completed certificate of exemption, Form S-207, to meet condition b. above, as provided in sec. Tax 11.14(7)(a)4, Wis. Adm. Code, March 1991 Register.

Because the organization will resell the club supplies and clothing, the organization may purchase such items exempt from Wisconsin sales and use tax by providing its suppliers with properly completed resale certificates, Form S-205.

The retailer must keep a copy of the billing or invoice and a copy of the certificate of exemption received from the organization.

## 2. Sales of Clothing and Supplies by Organization

Section 77.54(7m), Wis. Stats. (1993-94), provides that a non-profit organization's sales qualify as exempt occasional sales if it meets all of the following standards:

a. The organization is not engaged in a trade or business. A nonprofit organization is not engaged in a trade or business if it meets at least one of the following:

- 1) Its sales of otherwise taxable tangible personal property or services or its events occur on 20 days or less during the calendar year, regardless of the dollar amount of sales.
- 2) Its taxable gross receipts for the calendar year are \$15,000 or less, regardless of the number of days on which its sales or events occur. Nontaxable gross receipts are not included for purposes of the \$15,000 gross receipts test.

b. Entertainment is not involved.

c. The organization does not have or is not required to have a Wisconsin seller's permit, except for conducting bingo.

As provided in sec. Tax 11.35(1)(b), Wis. Adm. Code, June 1991 Register, "entertainment" means entertainment provided at an admission event by all persons or groups who are paid in the aggregate \$300 or more per

event by all persons for performing, for reimbursement of expenses, or for prize money.

As provided in sec. Tax 11.35(1)(c), Wis. Adm. Code, June 1991 Register, "gross receipts" means gross receipts as defined in sec. 77.51(4), Wis. Stats., from all sales of otherwise taxable tangible personal property and services after subtracting allowable exemptions.

Assuming that the forum does not involve entertainment, the organization qualifies for exemption from sales and use tax on its sales of club supplies and clothing to attendees at the forum because its Wisconsin sales are made on less than 20 days.

For purposes of the exemption provided in sec. 77.54(7m), Wis. Stats. (1993-94), the organization's educational and motivational speakers are not considered entertainment. □

✱ **W9526006**, April 12, 1995

### Type Tax: Sales and Use

**Issue:** Telecommunication services — prepaid telephone calling cards

**Statutes:** Sections 77.51(14)(intro.), (17m) and (21m) and 77.52(1) and (2)(a)5, Wis. Stats. (1991-92)

This letter responds to your client's request for a private letter ruling.

### Facts

ABC Corporation (ABC) is the owner and operator of convenience stores located throughout the United States.

ABC has entered into contracts with registered telecommunications service

providers to sell "units" of long distance telephone service. Each unit represents one minute of long distance telephone service. These units will be packaged by the telecommunications service provider in the form of telephone cards. Each card will have a value of 15, 30, or 60 units (minutes) of long distance service.

ABC will purchase a block of units from the telecommunications service provider for an agreed upon amount. The telecommunications service provider will provide the telephone cards to ABC. The telephone cards will identify the telecommunications service provider furnishing the telephone service. The amount charged by ABC to a customer for a telephone card will be determined by ABC.

The purchaser of the telephone card, to use the service, dials an access number printed on the card. The access number may be reached from any phone in the United States. The access line will be provided by the telecommunications service provider's own or underlying service network. The telecommunications service provider may or may not provide the switch (platform) through which the prepaid call is routed and rated and call details are recorded.

When the switch is accessed, the caller will be requested to enter a validation code. Upon successful validation, the caller will enter the telephone number of the party they wish to call. The switch will complete the connection and begin to meter time. Upon completion of the call, the caller will be given the amount of units or dollars worth of services used and remaining on the card by means of a real-time on-line rating system.

ABC will not know whether the telephone card is used by the purchaser and, if used, where the telephone call, using the telephone card, originated or terminated.

## Request

You ask the following questions:

1. Is the sale of prepaid telephone cards by ABC subject to Wisconsin sales or use tax or is the telecommunications service provider subject to Wisconsin sales or use tax with respect to the transactions described above?
2. If the sale of the prepaid telephone cards by ABC is subject to Wisconsin sales or use tax, is ABC selling tangible personal property or telecommunications services?
3. If the sale of prepaid telephone cards by ABC is subject to Wisconsin sales or use tax, is a sales or use tax also imposed when the telephone card is used by the purchaser?
4. If the telecommunications service provider is subject to Wisconsin sales or use tax on its sales of the telephone service, is the amount subject to tax the amount ABC pays the telecommunications service provider or the amount the purchaser pays ABC for the telephone card?

## Ruling

The sale of telephone cards by ABC is not subject to Wisconsin sales or use tax. The telecommunications service provider is subject to Wisconsin sales or use tax on the furnishing of the telecommunications services through the use of the telephone card, measured by the gross receipts received from ABC.

It is not necessary to address questions 2 and 3 of your request because the sale of the prepaid telephone cards by ABC is not subject to Wisconsin sales or use tax.

## Analysis

Section 77.52(1), Wis. Stats. (1991-92), imposes a Wisconsin sales tax on the sale of tangible personal property at retail in Wisconsin.

Section 77.52(2)(a), Wis. Stats. (1991-92), imposes a Wisconsin sales tax on the sale of certain services. Specifically, sec. 77.52(2)(a)5, Wis. Stats. (1991-92), provides that the sale of telecommunications services, not including services paid for by the insertion of coins in a coin-operated telephone, is subject to Wisconsin sales or use tax if the service originates in Wisconsin and is charged to a service address in Wisconsin, regardless of where that charge is billed or paid.

Section 77.51(21m), Wis. Stats. (1991-92), provides in part that "telecommunications services" means sending messages and information transmitted through the use of local, toll, and wide-area telephone service.

Section 77.51(17m), Wis. Stats. (1991-92), provides in part that "services address" means the location of the telecommunications equipment from which telecommunications services are originated or at which telecommunications services are received by a buyer.

"Sale at retail" is defined in sec. 77.51(14)(intro.), Wis. Stats. (1991-92), as the transfer of the ownership of, title to, possession of, or enjoyment of tangible personal property or services for use or consumption but not for resale as tangible personal property or services.

The sale of the telephone card by ABC is the sale of an intangible right. The sale of an intangible is not subject to Wisconsin sales or use tax under sec. 77.52(1) or (2)(a), Wis. Stats. (1991-92).

The telecommunications service provider is selling telephone services and is responsible for Wisconsin sales or use tax on the sale of those telephone services that originate in Wisconsin and are charged to a service address in Wisconsin. The telephone call made using the telephone card originates at the location where the person dials the access number on the card and enters the validation number. The service address is the location of the telephone equipment where the call is made using the telephone card, which is also the location where the person dials the access number on the card and enters the validation number.

The gross receipts subject to Wisconsin sales or use tax are the amounts received by the telecommunications service provider from ABC for telephone services that originate in Wisconsin and are charged to a service address in Wisconsin. The sale of the services takes place when the purchaser of the telephone card uses the telephone card to make a telephone call.

**Example:** ABC pays a telecommunications service provider \$10 for a 30 minute telephone card. ABC sells the telephone card to Individual A for \$12. Using the telephone card, Individual A makes a 30 minute telephone call from a telephone located in Wisconsin.

The \$12 charge by ABC to Individual A for the telephone card is not subject to Wisconsin sales or use tax. The \$10 charge by the telecommunications service provider to ABC is subject to Wisconsin sales or use tax at the time the telecommunications service provider furnishes the telephone service to Individual A. □