Wisconsin TAX BULLETIN

FOCUS ON . . .

Wisconsin Tax Bulletin
Annual Index

See pages 31 to 58.

Tax Bills Pending in Legislature

Several bills containing provisions that affect Wisconsin taxes have been introduced in the Wisconsin Legislature. None of these bills have been enacted into law as of the date this *Wisconsin Tax Bulletin* went to press.

The Wisconsin Legislature is scheduled to conclude its current session on May 16, 1996. If any bills which affect Wisconsin taxes become law, the new laws will be explained in a future issue of the *Wisconsin Tax Bulletin*. □

Do You Owe Use Tax?

If you were audited tomorrow, do you know in what area the auditor would likely find errors? Use Tax!

Most businesses make purchases subject to use tax. Perhaps you buy office equipment or supplies from out-of-state sellers. Or, you own a retail business, buy inventory for resale, and then occasionally **use** inventory items in your business.

You are required to pay Wisconsin use tax on these purchases if the seller did not charge you Wisconsin sales tax. Failure to pay use tax may result in the imposition of penalties and interest, in addition to the tax.

Additional information about use tax is contained in Wisconsin Publication 214, *Do You Owe Wisconsin Use Tax?*. Copies are available from any Department of Revenue office, or by fax, by calling the department's Fax-a-form number, (608) 261-6229, from a fax machine and entering retrieval number 10214. □

Focus on Publications: Auctioneers

Household goods, farm equipment, business assets, and motor vehicles – all of these are sold at auctions.

When must an auctioneer collect and pay sales tax? Answers can be found in the Department of Revenue's new Publication 217, *Auctioneers – How Do Wisconsin Sales and Use Taxes Affect Your Operations?*. This publication is available from any Department of Revenue office, or by fax, by calling the department's Fax-a-form number, (608) 261-6229, from a fax machine and entering retrieval number 10217. □

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

□

In This Issue

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Wisconsin Tax Bulletin Annual Index Included

Once each year the *Wisconsin Tax Bulletin* includes an index of articles, tax releases, court cases, private letter rulings, and other materials that have appeared in past Bulletins. The index for issues 1 (October 1976) to 95 (January 1996) can be found on pages 31 to 58 of this Bulletin. □

Refund Interception Program for Local Governments

On February 22, 1996, the Department of Revenue hosted the first orientation session for local governments signed up to participate in the refund interception program for county and municipal debts. A provision in 1995 Wisconsin Act 27 authorizes the Department of Revenue to intercept state tax refunds to pay unpaid fines, fees, restitutions, and forfeitures owed to local governments.

The department has set up a computer bulletin board service for local governments to use to transmit debt information to the department and receive information about refund intercepts. A publication describing the program is being prepared and will be distributed to local governments later in 1996.

Local governments interested in participating in the program may receive information about the program and an application to participate by writing to Wisconsin Department of Revenue, Refund Interception Coordinator, P.O. Box 8901, Madison, WI 53708-8901, or by calling (608) 267-0825. □

Wisconsin LLP Act Enacted

Effective December 11, 1995, 1995 Wisconsin Act 97 authorizes the organization and operation of limited liability partnerships (LLPs) in Wisconsin.

A "registered limited liability partnership" is a partnership formed pursuant to an agreement under Wisconsin law and registered with the Wisconsin Secretary of State's Office. A "foreign registered limited liability partnership" is an LLP

formed pursuant to an agreement under the laws of another state or country and registered under the laws of that jurisdiction. Foreign registered limited liability partnerships that are transacting business in Wisconsin must also register with the Wisconsin Secretary of State's Office.

Generally, a partner in a registered LLP is not personally liable directly or indirectly for any debt, obligation, or liability of the partnership, including any debt, obligation, or liability arising from omissions, negligence, wrongful acts, misconduct, or malpractice, arising while the partnership is a registered LLP. However, a partner may be held liable for any of the following:

(a) The partner's own omissions, negligence, wrongful acts, misconduct, or malpractice.

(b) The omissions, negligence, wrongful acts, misconduct, or malpractice of any person acting under the partner's actual supervision and control in the specific activity in which the omissions, negligence, wrongful acts, misconduct, or malpractice occurred.

(c) Any other debts, obligations, and liabilities resulting from the partner's acts or conduct other than as a partner.

(d) Any liability that the partner may have under sec. 13.69(1), Wis. Stats., relating to penalties for violations of the state's lobbying laws.

Currently, it is unknown what Wisconsin tax effects, if any, will result from the creation of LLPs. When additional information becomes available, it will be published in a future issue of the *Wisconsin Tax Bulletin*. □

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, nonprofit organizations, or businesses in general.
- What to expect in an audit.
- Common errors discovered in audits.
- Homestead credit.
- Farmland preservation credit.
- Manufacturing property assessment.

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. □

Taxation of Certain Retirement Income of Former Residents Preempted

Public Law 104-95, signed into law by the President on January 10, 1996, preempts state taxation of certain retirement income received by former residents. The law is effective for amounts received after December 31, 1995.

The new federal law will have limited impact on the Wisconsin individual income tax. Distributions former residents receive from **qualified** retirement and deferred compensation plans were already considered exempt from Wisconsin income tax, even if attributable to personal services performed in Wisconsin (per sec. Tax 3.085, Wisconsin Administrative Code). Therefore, only the provisions of Public Law 104-95 relating to **nonqualified** deferred compensation plans will impact Wisconsin in 1996 and future tax years.

Very little information concerning the specifics of Public Law 104-95 was available at the time this article was prepared (3/96). The following briefly describes its effect on states' taxation of nonresidents:

- prevents states from taxing distributions from retirement plans and arrangements that are considered "**qualified plans**" under the Internal Revenue Code (IRC). These are code sections 401(a), 408(k), 403(a), 403(b), 7701(a)(37), 457, 414(d), and 501(c)(18); and

- prohibits states from taxing distributions from **nonqualified deferred compensation plans** in two cases:

  (1) When the distribution is paid out in annuity form over the life expectancy of the individual or a period of not less than 10 years; and

  (2) When the distribution is paid in either an annuity or lump sum from arrangements known commonly as "mirror" plans.

A mirror plan is a nonqualified retirement plan maintained by an employer solely for the purpose of

providing benefits in excess of certain limits on contributions and benefits contained in the Internal Revenue Code which apply to qualified retirement plans. The benefits provided under a mirror plan are those benefits that would have been provided under the terms of a qualified retirement plan, but for the application of the following limits on contributions and benefits:

(1) Code section 401(a)(17): limits the amount of annual compensation that may be taken into account under a qualified retirement plan for purposes of computing benefits and contributions to $150,000.

(2) Code section 401(k): limits the amount of elective deferrals that may be made by a highly compensated employe to a qualified cash or deferred arrangement.

(3) Code section 401(m): limits the amounts of employer matching contributions and after-tax employe contributions that may be made to a 401(k) plan on behalf of highly compensated employes.

(4) Code section 402(g): limits the annual amount of elective deferrals that may be made to a 401(k) plan (or a similar arrangement).

(5) Code section 403(b): limits the amount of annual contributions that may be made to a tax-sheltered annuity maintained by certain tax-exempt entities and organizations.

(6) Code section 408(k): limits the amount of elective deferrals that may be made by a highly compensated employe to a simplified employe pension (maintained by smaller employers).

(7) Code section 415: limits the amount of annual benefits that may be paid from a defined benefit plan generally to the lesser of $120,000 or 100 percent of the participant's average compensation for the highest three years of compensation, and limits the amount of annual contributions that can be made to a defined contribution plan to the lesser of $30,000 or 25 percent of compensation.

As additional information concerning the effect of Public Law 104-95 becomes available, additional articles may be published in the Bulletin. □

Sales and Use Tax Contractor Publication Revised

Wisconsin Publication 207, *Sales and Use Tax Information for Contractors*, has been revised to reflect the changes described below. The revised Publication 207 with a revision date of "**2/96**," replaces Publication 207 with a revision date of "**7/94**."

The following revisions have been made (the page number where the item appears in the revised Publication 207 is given):

1. Information has been added regarding the Business Tax Registration fee (pages 1 and 2)

2. Information has been added regarding the stadium tax (pages 1 and 10)

3. Persons questioning the treatment of property installed in jails are asked to contact the Department of Revenue (page 4)

4. County tax information has been updated for counties that have adopted the county tax since 7/94 (pages 9 and 10)

5. Items have been added and changed in the chart that appears on pages 17 through 20 (see below for more information on the chart changes)

Chart Changes

Four new items have been added to the chart in Publication 207, which explains the characterization (real property (RE) vs. personal property (P)) of various items. The four new items that have been added and the pages they appear on in the publication are as follows:

- Faucets (not in bathrooms) – page 18
- Faucets (in bathrooms) – page 18
- Railroad Signs and Signals – page 19
- Street Identification Signs – page 20

In addition, the characterization of five items previously listed in the chart on pages 17 - 20 of Publication 207 has changed from either real property (RE) to personal property (P), or personal property (P) to real property (RE). The items in Publication 207 (2/96) as changed are as follows:

- Cabinets (in bathrooms) – Residential and Commercial – Real Estate Function – Repair – P (previously listed as RE in Publication 207 (7/94))
- Incinerators – Commercial – Process Function – Install – P (previously listed as RE in Publication 207 (7/94))

- Sinks (other than bathroom fixtures) – Commercial – Real Estate Function – Install – RE (previously listed as P in Publication 207 (7/94))

- Thermostats (wall-mounted) – Residential and Commercial – Real Estate Function – Repair – RE (previously listed as P in Publication 207 (7/94))

- Traffic Signs and Signals – Residential and Commercial – Install and Repair – P (previously listed as RE in Publication 207 (7/94))

The changes in characterization from RE to P and P to RE of these five items in Publication 207 apply to all periods open to adjustment.

For sales occurring prior to April 1, 1996, the following applies:

Repair of Cabinets (in bathrooms), Installation of Incinerators and Traffic Signs and Signals

If you treated the above items as real property improvements (position indicated in Publication 207 (**7/94**)) and paid Wisconsin sales or use tax based on your purchase price of the items, rather than the selling price of the materials and labor, you have two options:

1. Do nothing. The department will not adjust your sales and use tax liability for these items.

2. File a claim for refund for the sales or use tax paid on your purchase price of the items and report sales tax on the selling price of the item, unless an exemption applies.

If you treated the above items as personal property (position indicated in Publication 207 (**2/96**)) and charged your customers Wisconsin sales or use tax based on your selling price of the items (materials and labor), you do not have to do anything. You have treated the items in a manner consistent with the department's "revised" position as shown in Publication 207 (**2/96**).

Example 1 — In 1996 you are audited by the department for the year 1995. You did not charge Wisconsin sales tax on $2,000 worth of repairs made to bathroom cabinets for residential customers because you thought the repairs were real property improvements. You did, however, pay Wisconsin sales tax to your suppliers on your purchases of the materials ($500) used in making the repairs.

Although the department's "revised" position, as shown in Publication 207 (**2/96**), with respect to the repair of bathroom cabinets is that this service ($2,000) is subject to Wisconsin sales tax, the department will not assess you sales tax on the repairs of the bathroom cabinets ($2,000), nor will the department refund you the amount of Wisconsin sales and use tax you paid on your purchases of the materials ($500) used in the repairs of the bathroom cabinets.

Example 2 — In January of 1995, you installed traffic signals for a Wisconsin municipality for $5,000. You treated the installation as a real property improvement and, therefore, paid Wisconsin sales or use tax on your purchase price of the traffic signals ($2,000).

Since the department's "revised" position, as shown in Publication 207 (**2/96**), with respect to traffic signals is that the installation is an installation of personal property and subject to Wisconsin sales tax unless an exemption applies, you were not required to pay Wisconsin sales or use tax on your purchase of the traffic signals. In addition, because your sale was to a Wisconsin municipality, the $5,000 sale is exempt from Wisconsin sales and use tax.

You may file a claim for refund for the amount of Wisconsin sales and use taxes you paid on your purchase of the traffic signals from your supplier.

Example 3 — In February of 1995, you installed traffic signals for a Wisconsin municipality for $10,000. You treated this sale as a sale and installation of personal property. Since you were installing the traffic signals for a Wisconsin municipality, the $10,000 sale was exempt from Wisconsin sales and use tax. In addition, you did not pay Wisconsin sales or use tax on your purchase price of the traffic signals ($4,000).

Since the department's "revised" position, as shown in Publication 207 (**2/96**), with respect to traffic signals, is that the sale and installation is a sale and installation of personal property subject to Wisconsin sales tax unless an exemption applies, you do not need to do anything. You have treated the installation of the traffic signals in a manner consistent with the department's "revised" position as shown in Publication 207 (**2/96**).

Installation of Sinks (other than bathroom fixtures) and Repair of Thermostats (wall-mounted)

If you treated the above items as personal property and charged your customers Wisconsin sales or use tax based on your selling price of the items (materials and labor), you have two options:

1. Do nothing. The department will not adjust your sales and use tax liability for these items.

2. File a claim for refund for the amount of tax you charged to your customer. However, you would owe Wisconsin use tax based on your purchase price of these materials.

If you treated the above items as real property improvements and paid Wisconsin sales or use tax based on your purchase of the items, you do not need to do anything. You have treated the items in a manner consistent with the department's "revised" position as shown in Publication 207 (**2/96**).

Example 1 — In March of 1995, you repaired for $150 a wall-mounted thermostat that regulated a residential customer's furnace. You charged your customer Wisconsin sales and use tax ($150 x 5% = $7.50) on this repair. You did not pay Wisconsin sales or use tax on your purchase price of the materials ($50) used in making this repair.

Since the department's "revised" position, as shown in Publication 207 (**2/96**), is that wall-mounted thermostats for furnaces are real property and repairs to them are not subject to Wisconsin sales and use tax, you may file a claim for refund for the sales tax of $7.50 which you charged your customer in error.

However, if you file a claim for refund on your sale of the thermostat repair to your customer because the repair is a real property improvement, you would owe Wisconsin use tax ($50 x 5% = $2.50) on your purchase price of the materials ($50) used in the repair of the thermostat.

Example 2 — In December of 1995, you repaired for $200 a wall-mounted thermostat that regulates a residential customer's furnace. You treated the repair as a real property improvement and, therefore, paid Wisconsin sales or use tax based on your purchase price of the materials ($75) used in the repair of the thermostat.

Since the department's "revised" position, as shown in Publication 207 (**2/96**), is that thermostats for furnaces are real property and repairs to them are not subject to Wisconsin sales and use tax, you do not need to do anything. You have treated the item in a manner consistent with the department's "revised" position as shown in Publication 207 (**2/96**).

For sales occurring on or after April 1, 1996, the proper amount of Wisconsin sales and use tax must be paid to the department based on the positions reflected in Publication 207 (**2/96**).

Note: See *Wisconsin Tax Bulletin* 91 (April 1995), pages 21 to 26, for information about filing claims for refund and passing on the tax collected from buyers. □

1996 Estimated Tax Requirements for Individuals, Estates, and Trusts

Taxpayers who expect to owe $200 or more of tax and temporary recycling surcharge on a 1996 Wisconsin income tax return are required to pay 1996 Wisconsin estimated tax. There are exceptions for certain estates and trusts, as explained below. A 1996 Form 1-ES, Wisconsin Estimated Tax Voucher, is filed with each estimated tax payment.

For calendar year taxpayers, the first estimated tax payment is due on April 15, 1996. Installment payments are also due on June 17, 1996, September 16, 1996, and January 16, 1997. For fiscal year taxpayers, installment payments are due on the 15th day of the 4th, 6th, and 9th months of the fiscal year and the 1st month of the following fiscal year.

Estates and grantor trusts which are funded on account of a decedent's death are only required to make estimated tax payments for taxable years which end two or more years after the decedent's death. For example, an individual died on March 25, 1996. A grantor trust which was funded on account of the individual's death is not required to make estimated tax payments for any taxable year ending before March 25, 1998.

A trust which is subject to tax on unrelated business income is generally required to pay 1996 Wisconsin estimated tax if it expects to owe $500 or more on a 1996 Wisconsin franchise or income tax return (Form 4T). A 1996 Form 4-ES, Wisconsin Corporation Estimated Tax Voucher, is filed with each estimated tax payment. Installment payments for such trusts are due on the 15th day of the 3rd, 6th, 9th, and 12th months of the taxable year.

If a taxpayer does not make the estimated tax payments when required or underpays any installment, interest may be assessed. □

Sales and Use Tax Report Mailed

The March 1996 *Sales and Use Tax Report* (1-96), contains a number of articles regarding sales and use tax issues. This report was sent in late March to all persons registered for Wisconsin sales and use tax purposes. A copy of the report appears on pages 29 and 30 of this Bulletin. □

Question and Answer

Q I own a business that has multiple locations. I hold a Wisconsin seller's permit for each location from which I make sales of tangible personal property or taxable services.

Am I required to file a Wisconsin sales and use tax return for each location?

A No. You file one return for all business locations, reporting the total of gross receipts, deductions, and sales and use tax from all the locations on the one sales and use tax return.

Q I am expanding my business by adding a new location. I will be making sales of tangible personal property or taxable services from that location. I already hold a seller's permit for my current location.

Must I apply for a seller's permit for my new location?

A Yes. You are required to hold a seller's permit for each location from which you make sales of tangible personal property or taxable services.

Application for a seller's permit is made using Form A-101, which may be obtained from any Department of Revenue office. The seller's permit issued for your new location will have the same number as your current seller's permit but will have a letter suffix assigned.

A person who operates as a seller in Wisconsin without a permit is guilty of a misdemeanor.

Q I hold a Wisconsin seller's permit and am required to file my Wisconsin sales and use tax return on a monthly basis. There are some months when I have no taxable sales and no sales or use tax to report.

Am I required to file a sales and use tax return for a reporting period where I have no tax due?

A You are required by law to file a return even though you may have no tax liability for the period, unless you are a seasonal filer. Failure to file the return can result in a $10 late filing fee, even though no tax is due on the return.

A seasonal filer is one that is open for business only part of the year. The Department of Revenue will notify you if you are a seasonal filer. A seasonal filer is only required to file sales and use tax returns for the months of its business season, or if a liability is incurred during a reporting period when usually closed. □

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 59 of this Bulletin. The order blank may also be used for subscribing to the *Wisconsin Tax Bulletin* and for ordering the Wisconsin Administrative Code. □

Jail Time for Failure to File

Thomas B. Shepard, 51, 270 E. Highland Avenue, Milwaukee, was sentenced in January 1996, for failure to file Wisconsin income tax returns for 1991, 1992, and 1993. He pled guilty in November 1995 to all three counts. Milwaukee County Circuit Court Judge Kitty Brennan sentenced Shepard to 80 days in the House of Corrections with Huber privileges, and two years probation. During the probationary period he must pay restitution as well as the cost of prosecution. He must also provide 60 hours of community service to female or minority entrepreneurs seeking to enter the restaurant business.

According to the criminal complaint, Shepard failed to file Wisconsin income tax returns for the years 1991, 1992, and 1993. During those years, the complaint alleges, Shepard had gross income in excess of $3,000,000, which was his share of the income from Brew City Barbeque, Inc.

Failure to file a Wisconsin income tax return when due is a crime punishable by up to nine months imprisonment and up to $10,000 in fines. In addition to the criminal penalties, Wisconsin law provides for substantial civil penalties on the civil tax liability. Assessment and collection of the taxes, penalties, and interest follow a conviction for criminal violations.

William P. Doucas, 36, of Oconomowoc, a former Oshkosh car dealer, avoided jail time as part of a plea bargain arrangement in Winnebago County Circuit Court in February 1996. Doucas was facing 106 years in prison for 25 criminal counts against him and Doucas Motors, related to non-payment of over $150,000 in liens, failure to pay more than $196,000 of state sales and excise taxes, and taking more than $12,000 from employes' retirement contributions. Doucas pleaded no contest to the charges as part of the plea bargain.

Circuit Judge Robert Hawley stayed a two-year prison sentence and placed Doucas on probation for three years. He also ordered Doucas to perform 300 hours of community service, make restitution of $327,380, and pay a fine of $31,680. In addition, he may never work in the automobile business in Wisconsin again, and he must cooperate fully with providing needed documentation to the car dealership's new owners.

A self-employed Beloit painter, Daniel J. Welch, 41, was sentenced to jail in March 1996, for failing to file income tax returns. Rock County Circuit Judge James P. Daley ordered Welch to serve 30 days in jail and three years probation, and to pay $7,000 restitution to the state, plus court costs.

Welch was charged in March 1995 with failing to file 1991, 1992, and 1993 Wisconsin income tax returns, and in February 1996 he pled no contest to two counts. The criminal complaint stated he had gross income of over $105,000 for 1991 to 1993. □

Farmers Receive Nearly $47 Million in Tax Credits

Nearly $47 million in direct benefits were distributed to Wisconsin farmers in 1995 through two state programs, the farmland preservation credit program and the farmland tax relief credit program. About 23,900 Wisconsin farmers claimed farmland preservation credits amounting to $31.4 million, and nearly 61,500 farmers received farmland tax relief credits totalling $15.5 million in 1995.

Farmland Preservation Credit

Benefits averaging $1,317 per claimant were distributed through the farmland preservation credit program, which is designed to preserve Wisconsin farmland by encouraging local land use planning and soil conservation practices. Participating farmland owners received benefits averaging 29.4% of their property tax liabilities.

To qualify for relief under this program, farmland must be zoned for exclusive agricultural use or be subject to a farmland preservation agreement between the farmer and the state. About 83% of the claims were for land under zoning and 17% were for land covered by agreements.

Farmland Tax Relief Credit

Farmland tax relief credits averaging $253 were paid to farmers statewide in 1995. These credits equal 10% of the first $10,000 of property taxes on qualifying farmland, exclusive of improvements. This program, which is in addition to the farmland preservation credit, provides direct benefits to virtually all farmers in the state. □

Tax Publications Available

The Department of Revenue publishes over 45 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).

Publications can also be ordered by fax, using the department's "Fax-a-form" system by calling (608) 261-6229 from a fax telephone.

Number	Title of Publication (and last revision date)
102	Wisconsin Tax Treatment of Tax-Option (S) Corporations and Their Shareholders (12/95)
103	Reporting Capital Gains and Losses for Wisconsin by Individuals, Estates, Trusts (10/95)
104	Wisconsin Taxation of Military Personnel (8/95)
106	Wisconsin Tax Information for Retirees (11/95)
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 (3/96)
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 (3/96)
115	Wisconsin Federal/State Electronic Filing Handbook (9/95)
116	Income Tax Payments Are Due Throughout the Year (12/95)
117	Guide to Wisconsin Information Returns (6/95)
118	Electronic Funds Transfer Guide (12/94)
119	Limited Liability Companies (LLCs) (10/95)
120	Net Operating Losses for Individuals, Estates, and Trusts (11/95)
121	Reciprocity (10/95)
200	Sales and Use Tax Information for Electrical Contractors (10/95)
201	Wisconsin State and County Sales and Use Tax Information (9/95)
202	Sales and Use Tax Information for Motor Vehicle Sales, Leases, and Repairs (7/94)
203	Sales and Use Tax Information for Manufacturers (12/94)
205	Do You Owe Wisconsin Use Tax? (Individuals) (9/95)
206	Sales Tax Exemption for Nonprofit Organizations (9/90)
207	Sales and Use Tax Information for Contractors (2/96)
210	Sales and Use Tax Treatment of Landscaping (5/94)
211	Sales and Use Tax Information for Cemetery Monument Dealers (10/91)
212	Businesses: Don't Forget About Use Tax (7/94)
213	Travelers: Don't Forget About Use Tax (3/93)
214	Do You Owe Wisconsin Use Tax? (Businesses) (9/93)
216	Filing Claims for Refund of Sales or Use Tax (9/95)
217	Auctioneers – How Do Wisconsin Sales and Use Taxes Affect Your Operations? (3/96)
400	Wisconsin's Temporary Recycling Surcharge (12/95)
410	Local Exposition Taxes (11/94)
500	Tax Guide for Wisconsin Political Organizations and Candidates (9/95)
501	Field Audit of Wisconsin Tax Returns (2/96)
502	Do You Have Wisconsin Tax Questions? (10/95)
503	Wisconsin Farmland Preservation Credit (12/95)
504	Directory for Wisconsin Department of Revenue (10/95)
505	Taxpayers' Appeal Rights of Office Audit Adjustments (10/95)
506	Taxpayers' Appeal Rights of Field Audit Adjustments (10/95)
507	How to Appeal to the Tax Appeals Commission (10/95)
508	Wisconsin Tax Requirements Relating to Nonresident Entertainers (8/94)
509	Filing Wage Statements and Information Returns on Magnetic Media (3/94)
600	Wisconsin Taxation of Lottery Winnings (11/93)
601	Wisconsin Taxation of Pari-Mutuel Wager Winnings (3/94)
700	Speakers Bureau presenting ... (2/93)
W-166	Wisconsin Employer's Withholding Tax Guide (9/90) □

New Taxpayer Rights Initiatives From IRS

Note: The following article was submitted by Robert E. Brazzil, Director, Midwest District, Internal Revenue Service.

Change is everywhere, it seems. That is certainly true at the Internal Revenue Service. It is my pleasure to tell you that we have begun our official consolidation of the IRS operations in Wisconsin, Iowa, and Nebraska. On February 9, we officially became the Midwest District of the Internal Revenue Service, headquartered in Milwaukee.

Tax information & filing in an electronic world

There have been other changes for taxpayers this filing season. TeleFile, a system in which some single taxpayers can file their 1040EZ forms by touchtone phone, is proving to be a big success. Joint federal/state electronic filing continues to grow. And this year taxpayers can "surf the net" to find the tax forms and information they need.

The new IRS Home Page on the World Wide Web of the Internet (http://www.irs.ustreas.gov) went on-line January 8th as scheduled and was an immediate big hit with computer users — with more than 220,000 hits (that's the number of accesses) — in the first 24 hours. One week after its debut, the hit counter was up to more than a million. By mid-February, over 20 million hits had been reported.

Even the most novice internet user will find the page easy to navigate. Written in a simple, user-friendly format, the page offers everything from tax forms and publications to complete tax information for both individuals and businesses.

Under the heading of "Tax Information For You," users can find the answers to basic questions through "Tax Trails," an interactive session that poses key questions to identify the user's particular circumstances. Or users can cruise through a summary of important changes for 1995, or just find where to file their taxes.

Under "Taxpayer Help and Education," users can find simple summaries of 150 different tax topics, or answers to frequently asked questions.

Or, if users don't want to spend the time cruising the different options, the page offers two quick and easy ways to find the subject they're looking for — by a key word search or by the site tree where users can simply click on available topics.

Other features of the page include plain English summaries of recent IRS regulations; descriptions of IRS's electronic services such as TeleFile, FedState Electronic Filing and 1040PC; and Tax Information for Businesses.

The IRS is continually looking for alternative methods of providing taxpayers with information, and with 40 million Americans having access to the Internet, cyberspace is proving to be one of the most viable methods. Many more services will be available on the page in the near future, including a hypertext version of Publication 17 (Your Federal Income Tax), tax statistics, and the IRS Newsstand, where users can find a complete menu of IRS news releases and fact sheets.

New taxpayer rights initiatives

The Internal Revenue Service recently announced other changes — a series of new taxpayer rights initiatives as part of its ongoing efforts to reduce the burden on taxpayers when conducting business with the IRS and to make it easier for taxpayers to understand and exercise their rights. Highlights of the new initiatives include the following:

■ Enhanced Powers for the Taxpayer Ombudsman

Background. The Taxpayer Ombudsman has served since 1979 as the advocate for taxpayers within the IRS and has responsibility for administering the nationwide Problem Resolution Program. When a taxpayer faces a problem dealing with the IRS, the taxpayer may ask the Ombudsman, or one of the Ombudsman's Problem Resolution Officers based in local IRS offices, to intervene on the taxpayer's behalf to resolve the problem. If the taxpayer's complaint has merit, the Ombudsman will either negotiate a solution to the problem with IRS personnel or issue a Taxpayer Assistance Order (TAO) to order the IRS either to take or cease action, as the case may be, with respect to the taxpayer.

Details of new initiatives. Several new initiatives, effective January 1996, are designed to increase the Ombudsman's authority.

- In the past, A TAO issued by the Ombudsman could be overruled by a number of local IRS officials, including district directors, service center directors, compliance center directors, regional directors of appeals, or their superiors. The initiative increases the Ombudsman's authority by limiting those with authority to overrule, modify or withdraw a TAO to the Commissioner, Deputy Commissioner, or Ombudsman.

- To clarify the proper scope of a TAO, the Commissioner explicitly delegates to the Ombudsman the authority to direct the IRS through a TAO to issue a refund to relieve a severe financial hardship faced by a taxpayer. Likewise, the Ombudsman explicitly may issue a TAO to stop a collection action to ensure review of whether the action is appropriate.

- The Ombudsman will be required to prepare annual reports on the most serious taxpayer problems and suggest administrative and legislative solutions to them. The Ombudsman will establish a formal process to track the response of IRS officials to the administrative solutions identified in these annual reports.

- The Ombudsman's authority is being increased in local IRS offices by giving the Ombudsman greater power in selecting and evaluating local Problem Resolution Officers in IRS regions, districts and service centers.

■ Divorced and Separated Spouses

Background. Many taxpayers have expressed concern that the federal income tax system does not adequately address the unique problems faced by spouses who filed joint returns and later divorce or separate. For example, a divorced or separated spouse may not know of an IRS collection action against the other spouse on a joint tax liability.

Details of new initiatives.

- The IRS plans to adopt a new procedure by March 1996 to notify one spouse of actions taken against the other spouse to collect their joint taxes. The new procedure will have privacy safeguards to ensure that the procedure is used exclusively for tax purposes.

- The IRS has begun a study of the tax problems facing divorced and separated spouses. For example, the IRS will examine whether the tax liability of divorced or separated spouses should continue to be determined under a joint and several liability standard (that is, each spouse is potentially liable for all of the couple's taxes), or changed to a proportionate liability standard (that is, each spouse is liable for only the taxes attributable to a particular spouse's income) or even determined according to the couple's divorce decree. As another example, the innocent spouse provisions will be analyzed to determine if they provide any real relief to divorced and separated taxpayers. The goal of the study is to recommend legislative and administrative solutions to these problems where possible.

■ Computerized Record Storage and New Electronic Filing Options

Background. Many businesses, both large and small, have asked the IRS to adopt procedures to lessen the paper they must store to comply with the tax laws and the paper they must send to the IRS.

- The IRS intends to issue a Revenue Procedure to permit taxpayers — primarily businesses — to use computer imaging systems, rather than paper copies, to store the records necessary to properly support the information reported on their tax returns.

- The IRS recently issued Revenue Procedure 96-19 to permit employers to use electronic methods to file Form 941, "Employer's Quarterly Federal Tax Return," which reports the income tax withheld and the Federal Insurance Contributions Act (FICA) tax paid by the employer.

■ Expedited Appeals Procedure for Employment Tax Issues

Background. Many businesses, particularly small businesses, have asked the IRS to consider developing procedures to shorten the time necessary to resolve their employment tax disputes with the IRS, such as the classification of a worker as an employee or independent contractor.

Details of new initiative. The IRS will issue a new procedure to allow employers to appeal employment tax issues to Appeals even while an examination is in progress. This early referral procedure, modeled on the CEP early referral procedure in Rev. Proc. 96-9, should significantly reduce the time and expense necessary to resolve employment tax issues.

■ New Mediation Procedure

Background. The IRS recognizes that litigation is expensive and time consuming for both taxpayers and the IRS. The IRS is thus exploring various alternative dispute resolution techniques.

Details of new initiative. In October 1995, the IRS began a one-year test of a procedure that allows certain taxpayers in the Appeals process to request mediation of one or more issues. Mediation has already been used successfully to resolve one large valuation dispute. The IRS encourages taxpayers to consider the mediation procedure if applicable.

■ New Rules for IRS Investigations

Background. The IRS takes seriously its responsibility to protect taxpayers' rights in the course of carrying out its legal obligation to investigate tax cases. The IRS is adopting several new rules to better ensure that taxpayers' rights will be respected during investigations.

Details of new initiatives:

- The IRS strongly believes that it is inappropriate for an agent to compromise the tax liability of an informant in exchange for information about another taxpayer and is formalizing its longstanding practice, effective immediately, to explicitly prohibit this kind of behavior.

- The IRS now requires its agents (effective January 31, 1996) to make more extensive examinations of disputed information returns. This issue arises when a taxpayer claims that wage income reported on a Form W-2 or interest or dividend income reported

on a Form 1099 is incorrect. The IRS will increase its efforts to verify that the payor reported the correct amount of income to the IRS. In addition, to reduce the number of such disputes, the IRS will ask the payors who file Form 1099 information returns to include their telephone numbers on the taxpayer's copy of the returns, so that taxpayers can contact the payors directly with questions.

- Federal law permits the IRS or IRS agents to use a "designated summons" to obtain documents from taxpayers. These summonses can, in some circumstances, disadvantage taxpayers by extending the time for assessing taxes. Under the new initiative, effective immediately, IRS agents generally will not be permitted to use such a designated summons except for large corporate taxpayers, and only after review by high-level IRS officials.

■ Interest Netting

Background. Taxpayers ideally would like to offset the interest they owe on overdue taxes with the interest they can receive on tax refunds — a procedure known as "interest netting." While the IRS has already introduced some interest netting procedures in simpler situations, such computations can be difficult and expensive for taxpayers with more complicated taxes.

Details of new initiative. The IRS will conduct a study examining its current interest netting practices and investigate the feasibility of expanding such practices to cover new situations. Public comments soon will be requested.

Summary

Change is inevitable. But I can guarantee you that two things will not change. One is our continued commitment to our partnership with our colleagues at the Wisconsin Department of Revenue — and to our new colleagues at the Departments of Revenue in Iowa and Nebraska. The other is my desire to continue an ongoing dialogue with the members of the professional tax community throughout our new district. □

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 April 1, 1996, or at the stage in which action occurred during the period from January 2 to April 1, 1996.

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

11.47 Apportionment of net business income of interstate motor carriers of property-R&R

11.69 Financial institutions-A

Rules Being Reviewed Following Publication of Notice

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 Adopted But Not Yet Effective (anticipated effective date June 1, 1996)

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

2.31 Compensation received by nonresident members of professional athletic teams-NR

3.94 Claims for refund-R

Rule on Hold Pending Court Decision

11.04 Constructing buildings for exempt entities-A □

Report on Litigation

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

The following decisions are included:

INDIVIDUAL INCOME TAXES

Farm loss limitation. *David G. and Patricia Stauffacher vs. Wisconsin Department of Revenue* (Circuit Court for Dane County, February 5, 1996). The department seeks dismissal of the taxpayers' petition for judicial review of a Wisconsin Tax Appeals Commission (Commission) decision and order, which determined that they were engaged in a farming venture and were therefore subject to farming business loss limitations. For a summary of that decision, see *Wisconsin Tax Bulletin* 95 (January 1996), page 23.

The department maintains that the Circuit Court is without subject matter jurisdiction because the decision and order issued by the Commission in this matter is an interlocutory order rather than a final order, since the merits of the taxpayers' tax assessment is still pending before the Commission. The Commission has only determined one issue as to that tax assessment - that the activities engaged in constituted farming and that the farming loss limitation applies. It has yet to determine to what extent those activities were farming. This determination is crucial to determining the full extent of the taxpayers' tax liability. The Commission has neither reversed nor affirmed the department's complete assessment of tax liability and cannot do so until it decides the issues relating to research and manufacturing.

The Circuit Court concluded that the Commission's decision is interlocutory and that it lacks jurisdiction over the subject matter. It granted the department's motion to dismiss the appeal. After the Commission has made a full determination of the tax liability and has decided all of the issues in the case, the taxpayers may seek review on all issues. The appeal time in this matter does not run until a final decision is issued by the Commission. □

Rental expenses – allocation among owners. *Scott and Pamela McQuide, and Guy T. and Deborah L. Mascari vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, December 12, 1995). The issue in this case is whether the special allocations of paragraph 10 in the partnership agreement of the taxpayers have "substantial economic effect" as that phrase is defined and applied in Treas. Reg. § 1.704-1(b)(1) & (2), such that the deductions taken by the McQuides for the years under review were permissible, or whether the terms of the paragraph lack "substantial economic effect," rendering the special allocations impermissible and enabling the McQuides to deduct only those rental expenses in accordance with their respective interest in the property. Because the disputed issue in the case involved assessments issued in the alternative under sec. 71.74(9), Wis. Stats., the above dockets were consolidated for review before the Commission, as required under sec. 73.01(4)(i), Wis. Stats.

During January 1986, taxpayers Scott and Pamela McQuide ("the McQuides"), and Guy T. and Deborah L. Mascari ("the Mascaris"), purchased as tenants in common a two-unit residence located at 4059-61 North Downer Avenue in Shorewood, Wisconsin ("the Downer property"). The parties intended that the Mascaris would live in and bear the expenses of one of the two units at the Downer property, and that the second unit would be rented to a third party, with the parties equally sharing the expenses of the rental unit. The practical result is that the Mascaris were to be responsible for 75% of the expenses associated with the Downer property investment, while the McQuides were to be responsible for 25%.

In February 1986, the McQuides and the Mascaris executed a partnership agreement governing the terms of the acquisition, ownership, possession, management, and ultimate disposition of liquidation proceeds of the Downer property ("the partnership agreement"). According to the terms of the partnership agreement, the relative ownership, capital improvement contributions, operating expense burden, share of profits or losses, and share of liquidation proceeds were each to be divided among the two couples, 75% allocable to the Mascaris and 25% allocable to the McQuides. The overall 75% to 25% percentage split accurately reflected the comparative ownership interests and practical expense burdens of the Mascaris and the McQuides, respectively, from 1986 through 1992.

Paragraph 10 of the partnership agreement provided for a special allocation for income tax purposes, however, whereby the McQuides would realize "all of the tax advantages of the lower rental unit." The McQuides purportedly would be entitled to deduct all of the expenses associated with the rental unit, without regard to the actual payor of those expenses. The partnership agreement did not provide for any adjustment to the capital accounts or share bases of the individual partners to reflect the effects of the special allocations provided in paragraph 10 of the agreement.

Beginning in 1986, and for each year through 1992, the taxpayers prepared their respective annual income tax returns. The Mascaris deducted for each year all expenses incurred by them relating to the rental portion of the Downer property, paragraph 10 of the partnership agreement notwithstanding. The Mascaris did not inform the McQuides about their deviation from the terms of paragraph 10, having drawn an independent conclusion that the special allocation clause was vitiated by the terms of the other paragraphs of the partnership agreement. In contrast, the McQuides prepared their returns in accordance with the terms of paragraph 10 of the partnership agreement, at least for the years 1988 through 1991. Per their interpretation of paragraph 10, they deducted all of the expenses allocable to the rental unit of the Downer property.

Partnership returns were never prepared by the Mascaris or the McQuides to summarize and reflect distributable shares of income, loss, expense, etc.

In October 1992, the taxpayers sold the Downer property. According to the terms of a partnership settlement agreement executed at the time of the sale, the proceeds were split, with 25% being allocated to the McQuides and 75% to the Mascaris, based upon the underlying ownership percentages of each couple at the time.

The Commission concluded that the special allocations of paragraph 10 in the partnership agreement lack "substantial economic effect" as that phrase is defined and applied in Treas. Reg. § 1.704-1(b)(1) & (2), rendering the paragraph's special tax deduction allocations impermissible and enabling the McQuides to deduct only those expenses associated with the rental portion of the Downer property in accordance with their respective interest in the Downer property. Paragraph 10 of the partnership agreement lacked "substantial economic effect" because the special allocation did not correspond to the practical economic burdens of the partners, and there existed no provisions in the partnership agreement for the adjustment of the partners' capital accounts to reflect the arrangement contemplated in

paragraph 10, as required by Treas. Reg. § 1.704-1(b)(2)(iv).

As a result of the Commission's conclusion, the assessment issued to the McQuides is affirmed, and the assessments issued to the Mascaris are reversed.

Neither Scott and Pamela McQuide, Guy T. and Deborah L. Mascari, nor the department has appealed this decision. □

Tax Appeals Commission – class action claims; Petition for judicial review – timeliness. *Wisconsin Department of Revenue vs. J. Gerard and Delores M. Hogan, et al.* (Court of Appeals, District IV, December 21, 1995). This is an appeal from a judgment of the Circuit Court for Dane County. That judgment dismissed a petition for judicial review of the Tax Appeals Commission (Commission) decision directing that refunds be paid to the class comprising certain persons whose federal pensions had been taxed by the state, and ruled that the petition had not been filed by the department within the time prescribed by statute. For a review of the Circuit Court decision, see *Wisconsin Tax Bulletin* 90 (January 1995), page 19.

In early 1991, the Hogans wrote to the department, stating that they were changing their individual refund claim to one seeking refunds on behalf of the class certified by the Circuit Court in *Hogan v. Musolf* 163 Wis. 2d 1, 27, 471 N.W. 2d 216, 226 (1991). The department denied the claim, concluding that state law did not authorize the prosecution of class-action refund claims before the department. The denial was appealed to the Commission, and the department moved to dismiss the appeal.

On October 28, 1992, the Commission denied the motion to dismiss and granted the motion to recognize and certify the class. The order was not accompanied by the notice of appeal rights as a precondition for commencing the time limits in which petitions for rehearing or judicial review may be commenced. Thereafter, the Commission clarified its class-certification order and then clarified it again, each time modifying and altering the underlying rationale. Like the October 28, 1992, order, none of the amended orders was accompanied by an appeal notice.

On November 20, 1992, the department filed a "Respondent's Rehearing Petition" with the Commission. The Commission denied it, and that order was also unaccompanied by an appeal notice.

On May 27, 1993, the Commission rendered an oral decision, granting the motion to recognize and certify the class, and ordering refunds to all members of the class, together with statutory interest. Unlike all the decisions preceding it, the transcript of the oral decision provided to the parties was accompanied by the appeal notice. On June 16, 1993, twenty days after the oral decision, the department filed a petition for rehearing. The Commission denied the petition on June 29, 1993, and the department filed a petition for judicial review by the Circuit Court within thirty days of that date.

The Circuit Court ruled that the department's petition for judicial review of the Commission decision was untimely because it was not filed within thirty days of the date the oral decision was rendered. Because the Circuit Court dismissed the department's petition for review based on its conclusion that the petition had not been timely filed, it did not consider whether the Commission has the authority to certify and entertain a class action in refund proceedings. The Court of Appeals proceeded to decide that issue because it reviews the legal basis for the Commission decision independently, and because the parties fully briefed the issue.

The Court of Appeals concluded as follows:

A. The department's petition for review of the June 29, 1993, Commission decision was timely filed.

B. The Commission lacks authority to entertain a class-action proceeding seeking refunds of state income taxes collected over the years on the pension income of retired federal government employes living in Wisconsin. The Commission's class-action rulings in this case contravene two specific and plainly worded statutes.

   The first is sec. 71.75, Wis. Stats., which sets forth the requirements for filing and processing refund claims before the department. Section 71.75(6) mandates that "[e]very claim for refund" must be filed with the department "in the manner, and on a form ... signed by the person ... who filed the return on which the claim is based." By permitting the Hogans to change their appeal from one based on their individual returns to one representing a class of more than 25,000 other taxpayers, many of whom have never filed their own claims with the department, would effectively nullify the provisions of sec. 71.75(6), Wis. Stats., as to those taxpayers.

   Second, the statutes dealing with the Commission's appellate

jurisdiction expressly state that, in order to prosecute an appeal from the department's assessment of a tax, the taxpayer must, among other things, testify under oath before the Commission as to his or her actual income. Section 71.89(2), Wis. Stats. This provision, too, would be nullified if the Commission could add thousands of "absent" parties to the proceeding by permitting the Hogans' individual appeal to proceed as a class action.

The taxpayers have appealed this decision to the Wisconsin Supreme Court. □

CORPORATION FRANCHISE AND INCOME TAXES

Bad debts. *Wisconsin Distributors, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, December 6, 1995). The issue in this case is whether the department properly disallowed the taxpayer's expense deduction for charging off a part of the promissory note indebtedness of Wisconsin Eagle Snack Company Inc. ("Eagle"), pursuant to sec. 166(a)(2), Internal Revenue Code (IRC), where the taxpayer and Eagle were owned by the same interests within the meaning of sec. 71.11(7m), Wis. Stats. (1985-86).

During the period under review, November 1, 1984, through October 31, 1987, the taxpayer was a Wisconsin corporation using the accrual method of accounting, with its stock owned 51% by Darrell Hanson and 49% by John DeWitt.

Eagle was a Wisconsin corporation with its stock owned 51% by Darrell Hanson and 49% by John DeWitt.

The taxpayer leased to Eagle part of its facilities in Madison, Janesville, and Stevens Point, and entered into a written agreement ("the service agreement") to provide administrative and warehousing services to Eagle, including acting as joint paymaster, which were allocated between the corporations based on monthly dollar sales.

On November 1, 1985, Eagle's obligations to the taxpayer under the lease and the service agreement were memorialized into an unsecured 10% promissory note ("the note") in the initial principal amount of $89,059.64, with the balance adjusted each month as additional charges were incurred or payments made. At the taxpayer's fiscal year-end on October 31, 1987, Eagle owed the taxpayer $351,964 on the note.

In January 1988, the taxpayer decided to "charge off" $146,131 of the indebtedness owed by Eagle on the note during the year ended October 31, 1987, thereby reducing the indebtedness to $205,833. The taxpayer's financial statements characterized this as a "reduction" of previous "overcharge[s]" for selling expenses ($43,122), warehouse expenses ($14,237), general and administrative expenses ($36,742), and interest expense ($52,030).

On its 1987 Wisconsin franchise tax return, the taxpayer expensed the $146,131, which reduced its income accordingly. Although Eagle's 1987 tax return conversely included the $146,131 as expense *reductions*, it reported $0 net income.

On May 4, 1989, the department issued a notice of additional tax due from the taxpayer. The taxpayer petitioned for redetermination, which petition was denied by the department for the following reason:

> Information has not been provided to establish that the accounts receivable for Eagle Snacks Co., Inc. was partially worthless in the year claimed. Also, it was not shown that the worthlessness could be predicted with reasonable certainty. Therefore the accounts receivable written off ... does not qualify as a partially worthless debt under the provisions of section 166(a)(2) IRC.

The taxpayer claims that the debt adjustment write-off should be allowed as an expense because it had a bona fide business purpose relating to "real world performance, and the expectation of future improvement" and served "as a means of allowing Eagle to survive, rather than simply liquidating ..."

The Commission reached the following conclusions:

A. The taxpayer and Eagle were businesses owned or controlled by the same interests within the meaning of sec. 71.11(7m), Wis. Stats. (1985-86).

B. The department properly disallowed the taxpayer's expense deduction under review because the taxpayer did not substantiate that it was a partially worthless debt subject to charge-off within the taxable year as required by sec. 166(a)(2), IRC, or that it was deductible under any other code or statutory provision.

The taxpayer has not appealed this decision. □

Insurance companies – addback of exempt or excluded interest and dividends received deduction. *Wisconsin Department of Revenue vs. Heritage Mutual Insurance Company* (Circuit Court for Sheboygan County, November 17, 1995). The department filed a petition for review of the

Wisconsin Tax Appeals Commission's March 31, 1995, decision requiring the department to grant the refund claim filed by the taxpayer. The Commission concluded that the department improperly determined that sec. 71.45(2)(a)3 and 4, Wis. Stats. (1987-88), required the addition, for Wisconsin franchise and income tax purposes, of the 15% portion of interest and dividend income which never effectively reduced the taxpayer's federal taxable income as carried forward for Wisconsin purposes. See *Wisconsin Tax Bulletin* 92 (July 1995), page 16, for a summary of the Commission's decision.

The taxpayer is a Wisconsin corporation organized as a mutual insurance company under ch. 611, Wis. Stats. On its initial Wisconsin franchise tax returns for 1987 and 1988, the taxpayer added all of its federally exempt interest income identified on line 3b of Schedule A of its federal return and all of its federally exempt dividend income identified on line 34a of Schedule A to its federal taxable income shown on line 35 of Schedule A in order to compute its Wisconsin net income. On or about November 22, 1989, the taxpayer filed a claim for refund for the 1987 and 1988 taxable years respectively.

In determining its federal taxable income for 1987 and 1988, as required by sec. 832(b)(5) of the Internal Revenue Code (IRC), the taxpayer took into account 15% of the tax-exempt interest income received on obligations acquired on and after August 8, 1986, and 15% of deductible dividends received on stock acquired on and after August 8, 1986. In determining its Wisconsin taxable income for purposes of its claim for refund for 1987 and 1988, the taxpayer added back to its federal taxable income the tax-exempt interest and deductible dividends only to the extent that such amounts were not used in calculating its federal taxable income and, therefore, did not include the 15% of the tax-exempt interest income and deductible dividends included in its federal taxable income as required by IRC sec. 832(b)(5).

The Commission pointed out in its decision and order that the department interpreted the language of sec. 71.45(2)(a), Wis. Stats. (1987-88), to require the "add back" for Wisconsin purposes of 100% of federally exempt interest and dividend income even though 15% of such income was applied to reduce a loss deduction in arriving at the taxpayer's federal taxable income.

The Circuit Court concurred with the Commission's reasoning that the department's strict interpretation of the statute would tax the same income twice and affirmed the Commission's determination.

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

SALES AND USE TAXES

Aircraft – certified or licensed carriers; Purchases for resale. *Majestic Balloons Ltd. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, December 14, 1995). The issues in this case are:

A. Whether the taxpayer's purchase of a replacement fabric envelope for a hot air balloon system is exempt from sales and use tax under sec. 77.54(5)(a), Wis. Stats., as aircraft sold to persons using such aircraft as certified or licensed carriers of persons or property in interstate or foreign commerce.

B. Whether the taxpayer's purchase of the replacement fabric envelope is exempt from sales and use tax under sec. Tax 11.29(4)(b), Wis. Adm. Code, as a purchase for resale.

The taxpayer is a Wisconsin corporation engaged in the business of providing hot air balloon rides and using its hot air balloon system at promotional events. Gregory N. Rasske is the president of the taxpayer corporation.

In 1987 or before, the taxpayer purchased a hot air balloon system for use in its business but paid no sales or use tax on this purchase. The department then issued a notice of assessment asserting that the purchase was subject to the sales tax. Following a conversation between Mr. Rasske and an employe of the department, the department removed the notice of assessment because the taxpayer "supplied information showing the aircraft was purchased for rental only." The basis for the removal was not the exemption found in sec. 77.54(5)(a), Wis. Stats. (1989-90) but, rather, the resale exemption referred to in sec. Tax 11.29(4)(b), Wis. Adm. Code.

In 1990, the taxpayer purchased a replacement fabric envelope for the hot air balloon system. The initial hot air balloon system as well as the replacement fabric envelope is registered with the Wisconsin Department of Transportation and carries a registration number assigned by the Federal Aviation Administration ("FAA"). The hot air balloon system as well as the replacement fabric envelope must carry a certificate of airworthiness issued by the FAA.

The taxpayer is not certified or licensed as a carrier by an agency of the federal government, nor is the taxpayer required to be. There is no

evidence that the taxpayer is certified or licensed as a carrier by any foreign government. Mr. Rasske is a pilot licensed with the FAA, and such license is required by the FAA for flights provided by the taxpayer.

During the period relevant to this case, the taxpayer did not lease or rent the hot air balloon system to another person in a situation where the other person would operate the hot air balloon. During all flights, Mr. Rasske operates the hot air balloon system. When the taxpayer used the hot air balloon system to give rides to passengers, the purpose was the passengers' enjoyment or amusement, not transportation. At the end of each ride, the taxpayer transported the passengers to the place where the ride began.

The Commission concluded:

A. The taxpayer's purchase of the replacement fabric envelope is not exempt under sec. 77.54(5)(b), Wis. Stats., because the taxpayer is not a carrier that is certified or licensed under the laws of the United States or a foreign government.

B. The taxpayer's purchase of the replacement fabric envelope is not exempt as a purchase for resale under sec. Tax 11.29(4)(b), Wis. Adm. Code, because in the course of the taxpayer's business, Mr. Rasske always pilots the hot air balloon system and the taxpayer does not permit passengers to pilot the hot air balloon system.

The taxpayer has not appealed this decision.

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

Containers, packaging and shipping materials – plastic garment bags. *Luetzow Industries vs. Wisconsin Department of Revenue* (Court of Appeals, District I, October 31, 1995). This is an appeal from the April 15, 1994 decision of the Circuit Court for Milwaukee County. For a summary of the Circuit Court decision, see *Wisconsin Tax Bulletin* 91 (April 1995), page 15.

The issue in this case is whether the taxpayer's gross receipts from the sale of plastic garment bags to dry cleaners for use in returning a customer's dry-cleaned items are exempt from sales tax under sec. 77.54(6)(b), Wis. Stats. The taxpayer manufactured and sold plastic garment bags, trash bags, casket bags, and miscellaneous-purpose bags. The department determined that the taxpayer had improperly exempted gross receipts from the sale of garment bags to dry cleaners, and assessed sales tax on the garment bags sold on which no sales tax had been paid.

The taxpayer appealed to the Wisconsin Tax Appeals Commission ("Commission"), which concluded that the sale of garment bags to dry cleaners was taxable. The taxpayer then petitioned the Circuit Court, which reversed the Commission's decision, concluding that it could find no rational basis to narrowly interpret sec. 77.54(6)(b), Wis. Stats., so that the sale of garment bags to dry cleaners was not exempt from sales tax. It also held that the "common usage of the terms contained" in the statute brought the taxpayer's sale of the bags within the statutory exemption.

Section 77.52, Wis. Stats., imposes sales tax on the "gross receipts from the sale, lease or rental of tangible personal property." Section 77.54(6)(b), Wis. Stats., provides an exemption for the gross receipts from the sale of and the storage, use or other consumption of:

> "(b) Containers, labels, sacks, cans, boxes, drums, bags or other packaging and shipping materials for use in packing, packaging or shipping tangible personal property, if such items are used by the purchaser to transfer merchandise to customers ..."

The department argues that the garment bags sold by the taxpayer to the dry cleaners do not fall within the sec. 77.54(6)(b) exemption because the bags were not used by the dry cleaners "to transfer merchandise to customers." The Commission agreed with this interpretation, concluding that the items the dry cleaners transferred to their customers were not "merchandise," but instead:

> "[T]he transaction ... [was] a bailment, which involves no transfer of interest in the bailed property, but only delivery of temporary custody to accomplish a particular purpose which, when accomplished, requires the bailee either to redeliver the goods to the bailor or dispose of the property in accordance with the terms of the bailment."

The taxpayer counters, arguing that "'merchandise' includes 'goods'" which it defines as "'portable personal property.'" The taxpayer further argues that "to transfer merchandise to customers" does not require a "transfer or conveyance of title," but only "the shifting of portable personal property from one person (i.e., purchaser of plastic bags) to one who purchases some services (i.e., dry cleaning customers)."

The Court of Appeals concluded that the disputed statutory language: "to transfer merchandise to customers" was not intended to embrace the transfer of clothing or other sundries already owned by the customer, on which the dry cleaner has only performed a service. The crucial word in sec. 77.54(6)(b), Wis. Stats., is "merchandise." "Merchandise" denotes commodities or goods that are bought or sold.

The clothing or sundries a customer turns over to a dry cleaner are not bought or sold upon their return to the customer. The customer is paying for a service that the dry cleaner has performed on that item. Therefore, the clothing or sundries transferred back to the customer are not merchandise, but chattel originally conveyed to the dry cleaner under a bailment.

The Commission's reading of sec. 77.54(6)(b), Wis. Stats., was both rational and correct; the taxpayer's gross receipts from its sale of the garment bags to dry cleaners are not exempt from the state sales tax. Because the Commission correctly interpreted sec. 77.54(6)(b), Wis. Stats., the Circuit Court erred when it reversed the Commission's ruling on this issue.

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

Exemptions – common or contract carriers – constitutionality. *Wisconsin Steel Industries, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, January 23, 1996). The issue in this case is whether sec. 77.54(5)(b), Wis. Stats., as applied to the following facts, violates the equal protection clauses of the Wisconsin and United States constitutions.

During the years 1984 through 1990 ("period under review"), the taxpayer was a Wisconsin corporation engaged primarily in the business of steel treating and blasting. The taxpayer had three divisions. The largest division, Wisconsin Steel Treating & Blasting Co., accounted for the largest portion of the taxpayer's capital investment, was where most of the taxpayer's employes worked, and was the division from which the taxpayer derived most of its income. The business of this division consisted of heat treating and sand blasting steel.

Another division, the Steel Products Center, maintained an inventory of bar steel and other steel products for sale. The third division, Steel Transport Division, picked up steel from the taxpayer's customers for transport to the taxpayer's plant and then delivered the treated steel back to its customers.

During the period under review, the taxpayer was not a common or contract carrier that used the motor trucks, truck tractors, road tractors, trailers and semi-trailers it purchased exclusively as a common or contract carrier, and therefore, the taxpayer was not exempt from the use tax on such equipment under sec. 77.54(5)(b), Wis. Stats. Because the equipment mentioned above was not exempt, the repair services to such equipment were not exempt.

Had the taxpayer's Steel Transport Division been organized as a separate corporation, the primary business of such corporation would have been transportation services, and the transportation equipment of such corporation would have been used exclusively by such corporation as a contract carrier.

The Commission concluded that the sales and use tax exemption found in sec. 77.54(5)(b), Wis. Stats., as applied to these facts, does not violate the equal protection clauses of the Wisconsin and United States constitutions.

The protection afforded by Article I, Section I of the Wisconsin Constitution is substantially equivalent to the protection afforded by the equal protection clause of the 14th amendment to the United States Constitution, and, as a result, the same analysis applies under the equal protection guarantees of either constitution. In order to be a contract or common carrier for purposes of sec. 77.54(5)(b), Wis. Stats., the carrier's primary business must be transportation services and not some non-carrier business.

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

Exemptions – telephone company central office equipment. *Ameritech Mobile Communications Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, December 21, 1995). The issues in this case are:

A. Whether the taxpayer's cell site equipment is exempt from Wisconsin sales and use taxes under sec. 77.54(24), Wis. Stats.

B. Whether sec. 77.54(24), Wis. Stats., as it may be applied to the transactions involving the cell site equipment, is in violation of the Equal Protection Clauses of the constitutions of the State of Wisconsin and of the United States.

The taxpayer, a wholly-owned subsidiary of Ameritech Corporation, is a Delaware corporation, with its principal place of business in Illinois. During January 1, 1985 through December 31, 1988 ("the

taxable period"), the taxpayer and certain of its affiliates were engaged in the business of providing cellular telephone services in Wisconsin and elsewhere. The department has agreed not to contest the fact that the taxpayer is a "telephone company" within the meaning of sec. 77.54(24), Wis. Stats.

During the taxable period, the taxpayer's cellular telephone business in Wisconsin was conducted through two of its wholly-owned subsidiaries. Acting as procurement agent, the taxpayer purchased all of the equipment required for carrying on their cellular businesses. Such equipment, whether for use in the "MTSO" facility or the "cell sites" (as those terms are defined below), was purchased without payment of Wisconsin sales or use taxes. The department assessed sales and use taxes on the taxpayer's purchase and/or use of some of the cellular equipment. The parties have agreed that, to the extent sec. 77.54(24), Wis. Stats., is found not to apply to any such equipment, the taxpayer be responsible for any resulting sales or use taxes and interest.

The taxpayer's cellular system in Wisconsin consisted of three components: (1) the mobile units used by the taxpayer's customers (either hand-held or vehicle-installed devices); (2) company-owned facilities known as "cell sites," consisting of structures and equipment, one of which was located in each of the "cells" into which the taxpayer's service area was divided; and (3) a single, company-owned "Mobile Telephone Switching Office" ("MTSO").

One of the cell sites was "co-located" in the same structure as housed the MTSO. The department has agreed that the assessment with respect to the equipment at this "co-located" cell site will be reversed.

The equipment at issue consists solely of equipment purchased for and used at the cell sites (other than the "co-located" MTSO cell site). The department has not assessed any taxes with respect to the MTSO equipment. The department has agreed that the cell site equipment at issue is "apparatus, equipment and electric instruments, other than station equipment" and is used in "transmitting traffic and operating signals," as those phrases are used in sec. 77.54(24), Wis. Stats. Consequently, the only issue is whether such equipment is "in central offices" within the meaning of the exemption.

Mobile units can communicate with, and only with, cell sites. Mobile units cannot communicate directly with the MTSO and can communicate therewith only through a cell site. A cell site relays signals to the MTSO which, through switching equipment, connects the mobile to another mobile sitting adjacent to the first in the same cell site service area. Similarly, all connections between mobiles and land line telephone users are switched through the MTSO.

Cell site equipment does not perform the functions of "switching," as that term is used in the commonly accepted parlance of telephony, although it is clear that cell sites are necessary links in the communication chain which may be involved in prompting or subsequently implementing switching decisions. "Switching," as defined in the parlance of telephony, is the process of "interconnecting circuits in order to establish a temporary connection between two or more stations."

A "central office," in the common parlance of telephony, is "the facility housing the switching system and related equipment that provides telephone service for customers in the immediate geographical area."

The Commission concluded:

A. The cell site equipment at issue was not exempt from Wisconsin sales and use taxes under sec. 77.54(24), Wis. Stats., during the taxable period, because the equipment was not located in the taxpayer's "central offices" as that term is commonly used in the parlance of telephony.

   Accepted parlance of telephony and the interpretation of experts clearly indicates that the "central office" is a place where matrix switching, i.e., the construction of multiple channel input paths to multiple output paths, takes place. Expert testimony further indicated that in the context of cellular telephony, switching occurs at the MTSO level of the telecommunications link and does not take place any further "downstream" from the MTSO toward the mobile units. Because expert testimony also indicated that no switching occurs at the cell site in the technical sense, remote cell sites may not be considered to be "in central offices" as that phrase is used in sec. 77.54(24), Wis. Stats., and the exemption is not applicable to such cell equipment.

B. Section 77.54(24), Wis. Stats., as it may be applied to the transactions involving the cell site equipment here under review, is not found to be in violation of the Equal Protection Clauses of the constitutions of the State of Wisconsin and of the United States, as these constitutional issues were not timely raised in either the petition for redetermination or the petition for review in this case.

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

Services subject to the tax — repair and maintenance. *Badger U.S.A., Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, December 11, 1995 and February 9, 1996). The issue in this case is whether the taxpayer is liable for Wisconsin sales and use tax on its charges for:

A. Installation by the taxpayer of custom-designed reflectors in properties other than residential or non-commercial properties, including installation in some office areas of its customers.

B. Installation by the taxpayer of new fluorescent tubes, ballasts, and similar items when it installs reflectors.

The taxpayer manufactures reflectors that increase the amount of light emitted by light fixtures. These reflectors are installed in light fixtures, usually in existing structures throughout Wisconsin and elsewhere, including office areas.

A fluorescent light fixture typically has four bulbs and two ballasts. In the typical installation process, the taxpayer removes two of the bulbs and one ballast from an existing light fixture and installs a custom-made reflector along the inside of the light fixture. The reflector fits the contour of the inside of the light fixture and is held in place with four screws. Two of the bulbs are then replaced in the light fixture. With the exception of the removal of two of the bulbs and a ballast, the original light fixture remains unchanged.

The taxpayer custom manufactures reflectors for each location using lighting level data to optimize the product for each particular location. The reflector is manufactured at the taxpayer's Baraboo plant from reflector material purchased by suppliers and then shipped to the customer's facility.

Completed reflectors vary significantly because they are custom-designed for the facility for which they were sold. Two reflectors may have the same blank size but may have differing configurations dictated by, among other things, depth and shape of the light fixture housing and distribution of light.

Reflectors may be shipped by the taxpayer to other manufacturers for installation in new light fixtures manufactured for customers. In these cases, the light fixture is then shipped by the manufacturer to the customer's facility.

After the manufacturing process is complete, the order is shipped to the customer's facilities where the taxpayer retains an electrical subcontractor to install the reflectors. The taxpayer oversees and manages the installation, usually by telephone, at least once per week.

The reflectors allow light fixtures to produce the same amount of light as before installation but with less energy. Where the installation of reflectors results in a higher reflectivity level than the original reflecting surface, the installation may be an enhancement to the value of the property but will not affect the value of the property to any significant degree.

The taxpayer frequently installs new fluorescent tubes, ballasts, and other items when installing reflectors. Some of the taxpayer's sales were directly to the owners of buildings, not to contractors who would install the reflectors for the owners of buildings.

The Commission concluded, in its December 11, 1995 ruling and its February 9, 1996 modifying order, that:

A. The sales tax applies to the taxpayer's receipts for installation of reflectors into office, restaurant, and tavern type lighting equipment. To the extent the taxpayer's reflectors have been installed into office, restaurant, and tavern type lighting equipment, the exemption in sec. 77.52(2)(a)10, Wis. Stats., does not apply.

B. The sales tax applies to the taxpayer's receipts for the installation of new fluorescent tubes, ballasts, and similar items. Receipts for installation of these items fall squarely within the definition of "gross receipts" in sec. 77.51(4)(c)4, Wis. Stats., subject to taxation under sec. 77.52(1), Wis. Stats.

The taxpayer has not appealed this decision. □

FUEL TAXES

Assessments — authority; Assessments — statute of limitations. *Jones Oil Company, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, December 12, 1995). The issue in this case is whether the department properly assessed the taxpayer for special fuel taxes and general aviation fuel taxes under Ch. 78, Wis. Stats., and any applicable statutes of limitation.

The taxpayer was a telemarketer who sold and delivered special fuel and general aviation fuel to various customers in Wisconsin and other states during the period under review, which is January 1, 1986 through December 31, 1989 with respect to special fuel and January 1, 1988 through December 31, 1989 with respect to general aviation fuel. The taxpayer's sales to its customers included a charge for the appropriate Wisconsin fuel tax; i.e., the special fuel tax or the general aviation fuel tax.

The taxpayer held a general aviation fuel license pursuant to sec. 78.56, Wis. Stats. (1989-90). It was required to hold but did not hold a special fuel license pursuant to sec. 78.47, Wis. Stats. (1989-90). Although the department requested "numerous times" that the taxpayer file the special fuel tax reports required by sec. 78.49, Wis. Stats., the taxpayer did not do so. It did make some payments on account of its special fuel tax liability, but such payments are not at issue in this appeal.

In 1992, after receiving information from the Internal Revenue Service regarding fuel sales made by the taxpayer to customers in Wisconsin during the period under review, the department conducted a field audit to determine whether the fuel taxes due on such sales had been correctly reported and paid. As a result of the audit, the department issued assessments for special fuel tax and for general aviation fuel tax, both assessments including negligence penalties and interest.

The taxpayer was represented by its president, Terry L. Jones, at the hearing; he was the only witness who testified on behalf of the taxpayer. Although the taxpayer has objected to the assessments on various grounds, including non-delivery of fuel into motor vehicle tanks (special fuel), estoppel (special fuel), and statute of limitations (special and aviation fuels), no evidence or exhibits in support of its position were presented, other than Mr. Jones' testimony, which included the following statement: "My entire defense is on the basis of these [assessments] exceeding the statute [of limitations]."

The Commission concluded that the assessments by the department were proper and were not barred by any statute of limitations. Because the taxpayer offered no evidence at the hearing except the testimony of its president, it failed to meet the burden of proof set forth in sec. 78.70(4), Wis. Stats., which states that "the burden of proof shall be upon the licensee to show that the assessment was incorrect and contrary to law." The taxpayer's statute of limitations argument is grounded in sec. 78.66, Wis. Stats., which, the taxpayer claims, imposes a 3-year limitation on the assessments under review. However, sec. 78.66, Wis. Stats., is a record keeping requirement, not a limitation on assessments. Therefore, the taxpayer's position is without basis in fact or law.

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

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 the Self-Employment Tax Deduction

Statutes: Section 71.01(6), Wis. Stats. (1993-94)

Background: Section 1401 of the Internal Revenue Code (IRC) imposes a tax on the self-employment income of individuals. For purposes of computing federal adjusted gross income, sec. 164(f), IRC, allows the individual to claim a deduction for one-half of the self-employment tax imposed by sec. 1401 for the taxable year.

Wisconsin generally follows the Internal Revenue Code in effect for the prior year when computing Wisconsin taxable income for a taxable year. For example, sec. 71.01(6)(i), Wis. Stats. (1993-94 as amended by 1995 Act 27), provides that for taxable years beginning in 1994, "Internal Revenue Code" means the federal Internal Revenue Code as amended to December 31, 1993, with certain exceptions.

Because Wisconsin follows the Internal Revenue Code, the federal deduction for one-half of the self-employment tax allowable in computing federal adjusted gross income also applies for Wisconsin.

Purpose of Tax Release: This tax release explains the effect that an adjustment to self-employment income on a Wisconsin individual income tax return has on the related adjustment for one-half of the federal self-employment tax.

If there is an adjustment on the Wisconsin individual income tax return which increases or decreases self-employment income and that adjustment affects the amount of federal self-employment tax, the related deduction on the Wisconsin return for one-half of federal self-employment tax should also be adjusted. (**Note:** The deduction for one-half of the federal self-employment tax should be adjusted regardless of the fact that the federal return may not be subsequently amended because of the 3-year statute of limitations. The deduction for one-half of the self-employment tax is based on the self-employment tax imposed on the income, not on the amount paid.)

Example 1: Taxpayer A files his 1992 federal and Wisconsin income tax returns timely. Under federal law, the taxpayer has until April 15, 1996, to amend his 1992 federal income tax return. Under Wisconsin law, the taxpayer has until April 15, 1997, to amend his 1992 Wisconsin income tax return.

In July of 1996, Taxpayer A discovers that he underreported his 1992 self-employment income by $2,000. The taxpayer will amend his 1992 Wisconsin return but cannot amend his 1992 federal return. The additional income would have resulted in additional federal self-employment tax of $282.

Taxpayer A should amend his 1992 Wisconsin income tax return to report the additional $2,000 of self-employment income and to claim a deduction of $141 for one-half of the federal self-employment tax imposed on the $2,000 of additional self-employment income.

Example 2: During an audit of Taxpayer B's 1994 Wisconsin income tax return, it is discovered that Taxpayer B overreported her 1994 self-employment income by $5,000. The $5,000 decrease to self-employment income will also reduce the federal self-employment tax imposed by $706 and the related deduction for one-half of the self-employment tax by $353. The Department of Revenue will adjust the Wisconsin income tax return and issue a refund based on a decrease in Wisconsin taxable income of $4,647 ($5,000 decrease in self-employment income less the $353 adjustment to the deduction for one-half of self-employment tax).

(**Note:** Although not illustrated in these examples, other items on the return may also be affected when self-employment income is adjusted. For example, the temporary recycling surcharge, earned income credit, homestead credit, farmland preservation credit, and taxable unemployment compensation may need to be adjusted when changes are made to self-employment income.) □

2 Medical Care Insurance Deduction for Shareholders of S Corporations

Statutes: Sections 71.01(5) and 71.05(6)(b)19 and 20, Wis. Stats. (1993-94)

Wis. Adm. Code: Section Tax 1.06, June 1990 Register

Note: This tax release applies only with respect to taxable years beginning on or after January 1, 1995.

Background: Section 71.05(6)(b)19 and 20, Wis. Stats. (1993-94), provides a deduction for medical care insurance costs paid by certain persons. A self-employed person is allowed a deduction for 100% of medical care insurance costs paid by the person. For a person who is an employe whose employer does not pay any amount toward the person's medical care insurance, a deduction is allowed for 50% of the medical care insurance costs paid by the person.

For federal tax purposes, self-employed persons are allowed a deduction from gross income for 30% of health insurance costs paid by the self-employed person (sec. 162(L), Internal Revenue Code). The federal self-employed health insurance deduction is allowable to a shareholder owning more than 2% of the outstanding stock of an S corporation.

Section 71.01(5), Wis. Stats. (1993-94), provides that terms not otherwise defined have the same meaning as in the Internal Revenue Code (IRC) unless the context requires otherwise.

Question: A shareholder owning more than 2% of the outstanding stock of an S corporation is allowed the federal self-employed health insurance deduction. Is the shareholder considered an employe (entitled to a 50% deduction) or a self-employed person (entitled to a 100% deduction) for purposes of claiming the Wisconsin medical care insurance deduction?

Answer: A shareholder owning more than 2% of the outstanding stock of an S corporation is considered a self-employed person for purposes of claiming the Wisconsin medical care insurance deduction. Because Wisconsin law does not define self-employed person, the federal meaning applies. Under sec. 162(L)(5), IRC, shareholders owning more than 2% of an S corporation's stock are considered self-employed for purposes of the federal self-employed health insurance deduction. These shareholders are also considered self-employed for the Wisconsin medical care insurance deduction.

Note: For further information on the medical care insurance deduction as it applies to shareholders of S corporations, see the tax release titled "Medical Care Insurance Deduction" in *Wisconsin Tax Bulletin* 88 (July 1994), page 20. □

CORPORATION FRANCHISE AND INCOME TAXES

3 Tax-Option (S) Corporation's Treatment of Certain Exempt Bond Interest

Statutes: Sections 71.34(1) and 71.36(1m), Wis. Stats. (1993-94), as amended by 1995 Wisconsin Acts 27 and 56

Wis. Adm. Code: Section Tax 3.095, January 1994 Register

Note: This tax release supersedes the tax release with the same title that was published in *Wisconsin Tax Bulletin* 91, (April 1995), page 20.

Background: For the 1987 taxable year and thereafter, Wisconsin treats tax-option (S) corporations as pass-through entities, the same as for federal purposes. Items of income, loss, and deduction retain their character as business income or loss but pass through to the shareholders and are included in the shareholders' returns as if received or accrued, paid or incurred, directly by the shareholders.

For taxable years beginning before January 1, 1995, a tax-option (S) corporation may deduct from its net income all amounts included in the Wisconsin adjusted gross income of its shareholders, the capital gain deduction under sec. 71.05(6)(b)9, Wis. Stats., and all amounts not taxable to nonresident shareholders under secs. 71.04(1) and (4) to (9) and 71.362, Wis. Stats. For purposes of the tax-option corporation deduction, interest on federal obligations is not included in shareholders' income. Section 71.36(1m), Wis. Stats. (1993-94).

For taxable years beginning on or after January 1, 1995, sec. 71.36(1m) was amended by 1995 Wisconsin Acts 27 and 56 to provide that a tax-option (S) corporation may deduct from its net income all amounts included in the Wisconsin adjusted gross income of its shareholders, the capital gain deduction under sec. 71.05(6)(b)9, Wis. Stats., and all amounts not taxable to nonresident shareholders under secs. 71.04(1) and (4) to (9) and 71.362, Wis. Stats. For purposes of the tax-option corporation deduction, interest on federal obligations, obligations issued under sec. 66.066, Wis. Stats., by a local professional baseball park district, obligations issued under secs. 66.40, 66.431, and 66.4325, Wis. Stats., obligations issued under sec. 234.65, Wis. Stats., to fund an economic development loan to finance construction, renovation, or development of property that would be exempt under sec. 70.11(36), Wis. Stats., and obligations issued under subchapter II of chapter 229, Wis. Stats., is not included in shareholders' income.

Question: A tax-option (S) corporation is subject to a Wisconsin franchise tax measured by what types of interest and dividend income?

Answer:

A. *Taxable years ending on or after July 31, 1987, and beginning before January 1, 1995*

For taxable years ending on or after July 31, 1987, and beginning before January 1, 1995, a tax-option (S) corporation is subject to Wisconsin franchise tax measured by the amount of interest and dividend income received from obligations of the United States government and its instrumentalities, which is allocable to Wisconsin.

A tax-option (S) corporation is not subject to franchise tax measured by interest income on certain bonds issued by the government of Puerto Rico, other U.S. territories and possessions, and state and local governments that is exempt from the Wisconsin individual income tax. See section Tax 3.095, Wis. Adm. Code, for a list of exempt securities.

B. *Taxable years beginning on or after January 1, 1995*

For taxable years beginning on or after January 1, 1995, a tax-option (S) corporation is subject to Wisconsin franchise tax measured by the following interest and dividend income, which is allocable to Wisconsin:

- Obligations issued by the United States government and its instrumentalities.
- Municipal housing authority bonds issued under sec. 66.40, Wis. Stats.
- Municipal redevelopment authority bonds issued under sec. 66.431, Wis. Stats.
- Housing and community development authority bonds issued under sec. 66.4325, Wis. Stats.
- Bonds issued by the Wisconsin Housing and Economic Development Authority (WHEDA) under sec. 234.65, Wis. Stats., to fund an economic development loan to finance construction, renovation, or development of property that would be exempt from property tax under sec. 70.11(36), Wis. Stats. (professional sports and entertainment home stadiums).
- Bonds issued by a local exposition district under subchapter II of chapter 229, Wis. Stats.
- Bonds issued by a local professional baseball park district created under subchapter III of chapter 229, Wis. Stats.

Interest income from bonds issued by the government of Puerto Rico and other U.S. territories and possessions that is exempt from the Wisconsin individual income tax continues to be excluded from a tax-option (S) corporation's net income for Wisconsin franchise tax purposes. □

4 Wisconsin Corporation Tax Treatment of Dividends Received From a Real Estate Investment Trust (REIT)

Statutes: Section 71.26(2) and (3)(j), Wis. Stats. (1993-94)

Background: For federal income tax purposes, a corporation, with certain exceptions, trust, or association that specializes in investments in real estate and real estate mortgages and meets certain ownership and income requirements may elect to be taxed as a real estate investment trust (REIT). A REIT that distributes at least 95% of its taxable income for the taxable year and complies with certain requirements is generally treated as a pass-through entity. The REIT receives a dividends-paid deduction for the distributions made to its beneficiaries, and the distributed earnings are taxed to the beneficiaries. As a result, a REIT is subject to federal tax only on certain retained earnings, net income from foreclosure property, net income from prohibited transactions, and income that fails to meet certain requirements. See Internal Revenue Code (IRC) section 857 for additional information.

Internal Revenue Code sec. 857(c) provides that a dividend received from a REIT is not considered a dividend for purposes of the deduction under IRC sec. 243 for dividends received by corporations. As a result, a corporation receiving REIT dividends is subject to federal income tax on those dividends.

For Wisconsin purposes, a REIT computes its income under the Internal Revenue Code, with certain limited exceptions, as provided in sec. 71.26(2)(b), Wis. Stats. (1993-94). Thus, a REIT is generally treated as a pass-through entity for Wisconsin, the same as for federal purposes.

A corporation computes its Wisconsin net income under the Internal Revenue Code, with certain modifications prescribed in sec. 71.26(3), Wis. Stats. (1993-94). Sec. 71.26(2)(a), Wis. Stats. (1993-94). One of those modifications is sec. 71.26(3)(j), which excludes IRC secs. 243, 244, 245, 246, and 246A and replaces them with the rule that corporations may deduct from income dividends received from a corporation with respect to its common stock if the corporation receiving the dividends owns, directly or indirectly, during the entire taxable year at least 70% of the total combined voting stock of the payor corporation. Section 71.26(3) does not modify IRC sec. 857 for Wisconsin purposes.

Question: Assuming a corporation owns at least 70% of the common stock of another corporation that qualifies as a REIT, may the corporation claim the dividends received deduction under sec. 71.26(3)(j), Wis. Stats. (1993-94), for the dividends received from the REIT?

Answer: No, the corporation may not claim the Wisconsin dividends received deduction for dividends received from a REIT. Under IRC sec. 857(c), REIT dividends are not considered dividends for purposes of

IRC sec. 243. Section 71.26(3)(j), Wis. Stats. (1993-94), substitutes a Wisconsin dividends received deduction for the federal deduction under IRC sec. 243. Since IRC sec. 857(c) is not excluded from the Internal Revenue Code for Wisconsin purposes, this code section applies for Wisconsin. Thus, a dividend received from a REIT is includable in the corporation's Wisconsin net income. □

SALES AND USE TAXES

Note: The following tax release interprets the Wisconsin sales and use tax law as it applies to the 0.1% stadium sales and use tax. For information on sales or purchases that are subject to the stadium sales and use tax, refer to the December 1995 issue of the *Sales and Use Tax Report*. A copy can be found in *Wisconsin Tax Bulletin* 95 (January 1996), pages 41 to 47.

5 Stadium Tax — "Engaged in Business" in the Special District

Statutes: Sections 77.51(13g) and 77.79, Wis. Stats. (1993-94), secs. 77.71(1) and 77.73(1), as amended by 1995 Wisconsin Act 56, and sec. 229.67, as created by 1995 Wisconsin Act 56.

Introduction: In November 1995, the Professional Baseball Park District was created for purposes of assisting in the development of a professional baseball park in Wisconsin. This district is referred to in the Wisconsin Statutes as a "special district." The special district includes the following five Wisconsin counties: Milwaukee, Ozaukee, Racine, Washington, and Waukesha.

Effective January 1, 1996, the special district began imposing a 0.1% sales and use tax on the sale of, and the storage, use, or consumption of tangible personal property or taxable services in the special district. This sales and use tax is referred to as the "stadium tax."

Question: For purposes of the stadium tax, does a retailer determine whether it is "engaged in business" (has nexus) in the special district on:

1. A special district basis (nexus in one or more of the five counties is nexus in the entire special district), or

2. A per county basis (nexus is determined separately for each of the five counties)?

Answer: A retailer determines whether it is "engaged in business" (has nexus) in the special district on a "special district basis." Therefore, a retailer "engaged in business" (having nexus) in one or more of the five counties comprising the special district (Milwaukee, Ozaukee, Racine, Washington, or Waukesha county) is "engaged in business in the special district." Accordingly, any sales that occur in the special district (i.e., any sales in Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties) are subject to the stadium tax if the retailer is "engaged in business" (has nexus) in one or more of the five special district counties.

Note: A sale of tangible personal property takes place where possession of the property transfers from the seller or the seller's agent to the buyer or the buyer's agent. The rental or lease of tangible personal property takes place where the property will be located with the following exceptions:

1. The rental of motor vehicles and other equipment used principally on the highway at normal highway speeds takes place where they will be customarily kept, except that the rental or lease of drive-it-yourself motor vehicles and equipment used principally on the highway at normal highway speeds and used for one-way trips or leased for less than one month takes place in the county where they come in to the lessee's possession.

2. The rental or lease of moving property, other than in 1. above, takes place in the county where it will be primarily used or is usually kept.

A sale of services takes place where the service is furnished except:

1. The sale of communication services, if the customer calls collect or pays by credit card, takes place where the customer is billed.

2. The sale of towing services takes place at the location where the vehicle is delivered.

3. The sale of services to tangible personal property takes place where the property serviced is delivered to the buyer.

Caution: The above answer does not apply to the sale of motor vehicles, boats, snowmobiles, mobile homes not exceeding 45 feet in length, trailers, semitrailers, all-terrain vehicles, or aircraft registered or titled or required to be registered or titled in this state. The retailer is subject to the stadium tax on sales of such items if the items will customarily be kept in the stadium district, regardless of whether the retailer is "engaged in business" in the special district.

The examples below illustrate the above answer.

Example 1: Company A has its business location in Waukesha County. Company A sells tangible personal property in Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties. The tangible personal property sold is shipped from Company A's Waukesha location by common carrier to the customers in those counties.

Company A is "engaged in business" (has nexus) in the special district because of its business location in Waukesha County.

Company A's sales in Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties are subject to the stadium tax because **both** of the following apply:

a. Company A is "engaged in business" (has nexus) in the special district.

b. The sales take place in the special district (Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties).

Example 2: Company B has its business location in Kenosha County. Company B delivers the tangible personal property it sells to customers in Milwaukee County using its own trucks. Company B also sells tangible personal property in Ozaukee, Racine, Washington, and Waukesha counties. The tangible personal property is delivered to the customer by U.S. Mail in these 4 counties.

Company B is "engaged in business" (has nexus) in the special district because it uses its own trucks to deliver its products into Milwaukee County.

Company B's sales in Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties are subject to the stadium tax because **both** of the following apply:

a. Company B is "engaged in business" (has nexus) in the special district.

b. The sales take place in the special district (Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties).

Example 3: Company C has its business location in Illinois. Company C also has a sales office in Milwaukee County. Company C sells tangible personal property in Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties. The tangible personal property is delivered to the customers by common carrier.

Company C is "engaged in business" (has nexus) in the special district because of its sales office located in Milwaukee County.

Company C's sales in Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties are subject to the stadium tax because **both** of the following apply:

a. Company C is "engaged in business" (has nexus) in the special district.

b. The sales take place in the special district (Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties).

Example 4: Company D has its business location in Kenosha County. Company D sells tangible personal property to customers in Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties. The tangible personal property is delivered to the customers by common carrier. Company D also originates leases at its Kenosha location. The tangible personal property leased is non-moving property that will be located in Milwaukee County.

Company D is "engaged in business" (has nexus) in the special district because of its lease of tangible personal property in Milwaukee County.

Company D's lease and sale of tangible personal property in Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties are subject to the stadium tax because **both** of the following apply:

a. Company D is "engaged in business" (has nexus) in the special district.

b. The sale and lease of tangible personal property takes place in the special district (Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties). □

WITHHOLDING OF TAXES

6 Withholding on Director's Fees and Payments to Corporate Officers

Statutes: Sections 71.63 and 71.64, Wis. Stats. (1993-94)

Background: Section 71.64, Wis. Stats. (1993-94), provides that an employer must withhold Wisconsin income tax from the wages paid to an employe.

"Employe" is defined in sec. 71.63(2), Wis. Stats. (1993-94), as a resident individual who performs services for an employer anywhere or a nonresident individual who performs services within Wisconsin. The term includes an officer of a

corporation. "Employer" is defined in sec. 71.63(3), Wis. Stats. (1993-94), as a person (including a corporation), partnership, or limited liability company for whom an individual performs services. "Wages" is defined in sec. 71.63(6), Wis. Stats. (1993-94), as all remuneration for services performed by an employe for an employer. Some exceptions apply to the definition of "wages."

Question: Is a corporation required to withhold Wisconsin income tax from director's fees and payments to corporate officers?

Answer: Fees a corporation pays to an individual for performing services as a director are not subject to Wisconsin withholding as there is no employer/employe relationship between the individual and the corporation.

Amounts paid to an officer of the corporation for services are subject to Wisconsin withholding. An officer of a corporation is an employe of the corporation under sec. 71.63, Wis. Stats. (1993-94), and Wisconsin withholding is required on payments for services.

Note: An individual may perform services both as a director and as an officer of the same corporation. Remuneration paid to the individual for services performed in his or her capacity as a director of the corporation is not subject to Wisconsin withholding. Remuneration paid to the individual which is attributable to his or her duties solely as an officer of the corporation constitutes "wages" subject to Wisconsin withholding. □