

**TAX RELEASES**

*("Tax Releases" are designed to provide answers to the specific tax questions covered, based on the facts indicated. However, the answers may not apply to all questions of a similar nature. In situations where the facts vary from those given herein, it is recommended that advice be sought from the Department. 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.)*

**INCOME TAXES**

**I. Proration of Tax Paid to Another State**

**Facts & Question:** A part-year resident of Wisconsin who moved into Wisconsin in July of 1980 received income during 1980 which was taxable both by Wisconsin and another state. A total of \$10,000 of income was taxed by the other state. For Wisconsin purposes \$1,000 of this same income was required to be included in Wisconsin taxable income. This individual's net tax computed on the other state's income tax return was \$450.

What amount may be claimed under s. 71.09 (8) (c), Wis. Stats., as credit for tax paid to another state on line 57 of this individual's 1980 Wisconsin Form 1?

**Answer:** \$45. Since only part of the income taxed by the other state was also taxable by Wisconsin, the total tax paid to the other state may not be claimed as a credit. The total tax must be prorated using the following formula to determine the amount allowable as a credit:

$$\frac{\text{Income Taxable to Both Wisconsin and Other State}}{\text{Total Income Taxable to Other State}} = \text{Proration Ratio}$$

$$\text{Proration Ratio} \times \frac{\text{Total Net Income Tax Paid to Other State}}{\text{Amount of Net Income Tax}} = \text{Allowable as a Credit Against Wisconsin Tax}$$

Based on the facts given above, the credit in this case would be computed as follows:

$$\begin{aligned} & \frac{\$1,000 \text{ (Income taxed by both states)}}{\$10,000 \text{ (Total income taxed by other state)}} \\ & \qquad \qquad \qquad = 10\% \text{ proration ratio} \\ & 10\% \text{ (proration ratio)} \times \$450 \text{ (total net tax paid to other state)} \\ & \qquad \qquad \qquad = \$45 \text{ (credit allowable)} \end{aligned}$$

This credit would be claimed on line 57 on page 2 of the 1980 Form 1.

**II. Gain or Loss on U.S. Government Obligations**

Wisconsin Statute 71.05 (1) (b) provides for a subtraction modification for U.S. government interest which is exempt from state taxation under federal law. Although U.S. government interest is not taxable for Wisconsin income tax purposes, gains resulting from the disposition of negotiable government securities are taxable. Therefore, when a sale occurs, a taxpayer must distinguish between tax-exempt interest income and any gain realized.

Long-term (maturity in excess of one year from date of issue) government obligations such as treasury notes and treasury bonds are interest-bearing securities which are originally issued at par and are redeemable at par on the maturity date. These securities are freely negotiable instruments and will fluctuate in price in the open market. If held for investment purposes they qualify as capital assets.

Interest income received on long-term government obligations is not subject to Wisconsin income tax. If the securities are sold between interest dates, the accrued interest is not taxable to the seller.

Although originally issued at par, U.S. Treasury notes and bonds are often purchased at a discount or premium by subsequent holders. Neither the discount nor the premium paid has any effect on the amount of tax-exempt interest income. The discount or premium will affect the gain or loss realized on the sale or redemption of the securities.

**Example 1:**

On July 5, 1978 a two-year \$10,000 U.S. Treasury note is issued to "A" at par. Interest of 7% is paid semi-annually on January 5 and July 5. "A" holds the note for investment purposes. On April 5, 1980 "A" sells the note to "B" for \$10,050. "B" holds the note to maturity. "A" is entitled to treat the accrued interest of \$175 for the period January 5, 1980 to April 5, 1980 as tax-exempt. "A" sustains a capital loss of \$125 in the transaction, computed as follows:

Cost of the note		\$10,000
Deduct:		
Amount realized from the sale	\$10,050	
Less: Tax-exempt interest		
(10,000 x 7% x 3/12)	175	9,875
Amount of capital loss		<u>\$ 125</u>

Since the sales price of \$10,050 included \$175 for accrued interest (January 5 to April 5), "B's" basis in the note is \$9,875. "B" realized a capital gain of \$125 (\$10,000 minus \$9,875) upon redemption.

Of the \$350 interest payment received by "B" on July 5, 1980, \$175 (the interest for January 5 to April 5) is merely a return of capital and is not taxable for federal purposes. The \$175 of interest from April 6 to July 5 which accrued after "B" purchased the note, is taxable interest income for federal income tax purposes, but exempt for Wisconsin.

U.S. Treasury bills are short-term obligations (one-year or less) that are issued at a discount and are redeemable at par. They are non-interest bearing securities but the original issue discount earned is treated as interest. These securities are excluded from the definition of capital assets under Internal Revenue Code section 1221 (5).

The original issue discount on Treasury bills does not accrue until the bills are sold or redeemed. If the securities are sold prior to maturity, the original issue discount accrued will be considered tax-exempt interest to the seller.

As with long-term government obligations, any additional discount which results from a subsequent sale of the securities will not affect the amount of tax-exempt

interest income. The discount will affect the gain or loss realized on the sale or redemption of the securities.

#### Example 2:

A 90-day U.S. Treasury bill is issued to "A" on January 5, 1979 for \$9,800. The security has a maturity value of \$10,000 on April 6, 1979. "A" sells the obligation to "B" on February 5, 1979 for \$9,890. "B" holds it to maturity. "A" is entitled to treat \$67 (30/90ths of the \$200 discount) as tax-exempt interest.

"A" realizes a taxable gain of \$23, computed as follows:

Amount realized from sale	\$9,890
Deduct tax-exempt interest	67
Balance realized from sale	\$9,823
Cost of the Treasury bill	9,800
Amount of ordinary gain realized by "A"	<u>\$ 23</u>

"B" is entitled to treat \$133 (60/90ths of the \$200 discount) as tax-exempt interest. "B" sustains a deductible loss of \$23, computed as follows:

Cost of U.S. obligation	\$9,890
Deduct:	
Amount realized at maturity	\$10,000
Less: Tax-exempt interest	133
Amount of ordinary deductible loss	<u>\$ 23</u>

### CORPORATION INCOME/FRANCHISE TAX

#### I. Deduction of Cost of Pollution Abatement Equipment by Second Owner

**A. Facts & Question:** Corporation A purchased the inventory, property, plant and equipment (including pollution abatement facilities) of Corporation B. After the acquisition, Corporation A operated the same as Corporation B did prior to the purchase. May the acquiring corporation elect (under s. 71.04(2g) (a), Wis. Stats.) to deduct the cost of the pollution abatement equipment, even though such equipment was deducted (under s. 71.04(2g) (a), Wis. Stats.) by the original owner? If deductible, when is the deduction allowed?

**Answer:** Yes, when a corporation acquires by purchase used pollution abatement equipment, the acquiring corporation does qualify for the election under s. 71.04(2g) (a), Wis. Stats.. The deduction is allowed in the year of acquisition. Depreciation or amortization, if elected, starts with the month or year following acquisition.

**B. Facts and Questions:** Corporation X, which first acquired and wrote off the cost of the pollution abatement equipment, was acquired by Corporation Y through purchase of its outstanding stock. Within two years of the stock purchase, Corporation Y liquidated Corporation X and allocated its cost of stock to the assets acquired from X. (1) Is the amount of the prior year's deductions attributable to Corporation X's write-off of pollution abatement equipment recaptured as ordinary income by Corporation X under s. 71.03 (1), Wis. Stats., when its stock is sold or when it is completely liquidated? (2) Can Corporation Y allocate a part of Corporation X's purchase price to the pollution abatement equipment acquired and then deduct such purchase price immediately, pursuant to s. 71.04(2g) (a), Wis. Stats.?

**Answers:** (1) No, Wisconsin law does not require Corporation X to restore the pollution abatement equipment write-off to income either at the time Corporation Y acquired its stock or at the time X was liquidated into Y, since neither transaction involved the disposition of X's assets involving a sale and purchase in which gain or loss was recognized. (2) The liquidation of X, by which Y acquired the pollution abatement equipment, does not qualify as being "purchased or constructed" as a waste treatment facility under s. 71.04(2g), Wis. Stats., and therefore an immediate write-off is not allowed. At the time of acquisition by Y, the transaction involved the purchase of stock and not the purchase of qualifying waste treatment facilities. The depreciation or amortization permitted to be deducted by Y is limited to the amount deductible under the Internal Revenue Code pursuant to s. 71.04(15), Wis. Stats..

#### II. Television Film Rentals Included in Property Factor for Apportionment

**Facts & Question:** A corporation conducting business activities in Wisconsin and in other states operates a television station in Wisconsin. In operating the television station, the corporation rents films which it is entitled to show a specified number of times.

Does the rental of these films constitute the rental of tangible personal property, and if so, should the rental be capitalized at 8 times the net annual rental and included in the property factor for apportionment purposes under s. 71.07(2) (a) 3, Wis. Stats.?

**Answer:** Yes, the rental of these films is considered the rental of tangible personal property and all of the net annual rental is multiplied by 8 and included in the property factor for apportionment purposes.

#### III. Treble Damages Under Federal Antitrust Laws

**Facts & Question:** A corporation was assessed treble damages in a class action suit under the Federal Antitrust Laws. Is this expense deductible for Wisconsin purposes as an ordinary and necessary business expense under s. 71.04, Wis. Stats.?

**Answer:** Yes, the deduction is allowed in full for Wisconsin purposes, as an ordinary and necessary business expense. Wisconsin's treatment of this item is based on federal Revenue Ruling 64-224 which states that amounts paid or incurred in satisfaction of claims for treble damages under Sec. 4 of the Clayton Act are deductible as ordinary and necessary business expenses. In Revenue Ruling 64-224, the Internal Revenue Service held these payments to be remedial in nature and intended as reparation for a private injury so that they may be deducted for income tax purposes.

Two exceptions to full deductibility are made for federal purposes, as follows: (1) no deduction is allowed if payment of a penalty is made to the United States government, since such a payment is not remedial in nature but is punishment for injury to the public, and (2) under Internal Revenue Code section 162(g), two-thirds of payments to parties other than the federal government are not deductible in cases of hard-core violations where intent has been clearly proven in a criminal proceeding. Two-thirds of the payment represents the penal portion of the damage claim.

Wisconsin follows only the first of the federal exceptions. The second exception does not apply to Wisconsin tax returns since Wisconsin has no law similar to federal section 162 (g).

## SALES/USE TAX

### I. Photocopy Charges

**Facts & Question:** A law firm bills clients separately for photocopies it provides clients. These charges for photocopies approximate \$5,000 each year. Are these charges for photocopies subject to the sales tax?

**Answer:** Yes, charges for photocopies in this case constitute the sale of tangible personal property and are taxable under s. 77.52 (1). Also, receipts of \$5,000 in a year exceed any possibility of an occasional sale exemption.

### II. Waste Treatment Facility Approvals

**Facts & Question:** Section 77.54 (26), Wis. Stats., provides that an industrial waste treatment facility must qualify for exemption under s. 70.11 (21) (a), Wis. Stats., for property tax purposes before an exemption applies for sales tax purposes on purchases of building materials used to construct the facility. A waste treatment facility qualifying under s. 70.11 (21) (a), Wis. Stats., was constructed in 1977, but the owner did not file the statement required in s. 70.11 (21) (c), Wis. Stats., until 1980. Does obtaining the property tax exemption in 1980 create a sales and use tax exemption under s. 77.54 (26) for building materials purchased in 1977 under these facts?

**Answer:** Yes. This waste treatment facility obtained the property tax exemption by complying with s. 70.11 (21) (c) in 1980, but would have been entitled to such an exemption in 1977, 1978 and 1979 if a timely statement had been filed. The sales tax exemption in s. 77.54 (26) applies to building materials purchased in 1977 which became a component part of a qualifying facility under s. 70.11 (21) (a). (Note: The answer would be the same if a municipal waste treatment facility was involved instead of the waste treatment facility mentioned in this Tax Release.)

### III. Manufacturing - Alcohol Production on Farms

**Facts & Question:** A farmer produces a small amount of alcohol on the farm for use in his or her farm tractors. Does the farmer qualify as a "manufacturer" for sales tax purposes under s. 77.51 (27), Wis. Stats.?

**Answer:** No, the farmer is not considered a "manufacturer" for sales tax purposes. However, the farmer is entitled to claim the exemption for machinery and equipment used in farming under s. 77.54 (3) when acquiring the equipment used to produce the alcohol.

### IV. Nontaxable Building Service

**Facts & Question:** A company provides a service which consists of checking a building's heating, ventilation and air conditioning systems for balance and advising the customer where improvements can be made. Is this service subject to sales tax?

**Answer:** No, this is not one of the services taxable under s. 77.52 (2), Wis. Stats. Checking a system for balance is

distinguishable from servicing and inspecting such property under s. 77.52 (2) (a) 10.

### V. Delivering Trees to Job Site

**Facts & Question:** After a customer purchases a tree from a nursery for \$300 (including delivery and placing in the hole) the customer and an employe of the nursery decide on the place to locate the tree. The nursery employe then specifies the exact dimensions of the hole needed for the tree, and the customer digs the hole. The nursery employe delivers the tree to the hole with special equipment and places the tree in the hole. After the nursery employe is satisfied the tree is spotted properly, the employe removes his equipment and leaves. The customer then covers the tree roots. Is this the sale of personal property by the nursery, or is the nursery engaged in improving realty?

**Answer:** This is a sale of personal property and the \$300 gross receipts from the sale are subject to the sales tax under s. 77.52 (1), Wis. Stats. The nursery is not considered to have improved real property in this situation.

### VI. Is a Hatchery a "Farmer"?

**Facts & Question:** A hatchery hatches eggs and sells the chicks to farmers or poultry raisers. Is this hatchery engaged in "farming" and therefore entitled to the farming exemption in s. 77.54 (3) and (3m), Wis. Stats.?

**Answer:** No, the activities of this hatchery are not considered farming and therefore it is not entitled to the exemption in s. 77.54 (3) and (3m).

### VII. Property Taxes Paid By Lessee

**Facts & Question:** A lessor rents tangible personal property to a lessee in a transaction which is subject to the sales tax. The lease provides that the lessee must pay the local property taxes on such property. Is the payment of the property taxes by the lessee includible in the lessor's taxable gross receipts?

**Answer:** The answer hinges on whether the personal property tax is assessed and levied against the lessee or lessor. If the tax is levied against the lessor, the lessee's payment of the tax is includible in the lessor's taxable gross receipts, regardless of whether the lessee is billed by the taxing agency and pays the tax directly to the agency or pays the tax to the lessor who in turn pays the taxing agency. If the tax is assessed and levied against the lessee, it is not includible in the lessor's gross receipts.

### VIII. Sales of Eggs

**Facts & Question:** Poultry eggs are usually sold by farmers and they are purchased by wholesalers, retailers, household consumers, farmers, hatcheries and others. Are such egg sales taxable?

**Answer:** Sales of eggs are subject to the 4% sales/use tax unless a specific exemption applies to the particular transaction. Sales of poultry eggs in examples 1 and 2 below are subject to the sales/use tax because they are not sold for human consumption as required by s. 77.54 (20) (intro.), Wis. Stats., and are not otherwise exempt:

1. Sales of eggs to hatcheries which hatch the eggs and immediately sell the young chicks to farmers.

2. Sales of eggs to laboratories that use the eggs for experiments.

Sales of poultry eggs in examples 3-7 are exempt from the sales/use tax when sold to:

3. An individual purchasing eggs for the home preparation of meals (s. 77.54 (20), Wis. Stats.).

4. A restaurant purchasing eggs for the preparation of meals (s. 77.54 (20), Wis. Stats.).

5. A manufacturer of frozen pizzas purchasing eggs for the production of pizza (s. 77.54 (20), Wis. Stats.).

6. A wholesaler or retailer purchasing eggs for resale to other persons.

7. A farmer purchasing eggs to raise chickens (s. 77.54 (3), Wis. Stats.).

#### IX. Occasional Sales by Nonprofit Organizations

**Facts & Question:** A nonprofit organization, not engaged in a trade or business and not otherwise required to have a seller's permit, sells beer and restaurant meals at an annual local 3 day festival. At other times during the same year it also had a 10 day sale of frozen pizza (receipts \$1,200), and a 4 week sale of radio advertising (receipts \$1,000), neither of which are subject to the sales tax.

**Question A:** Are the sales of frozen pizza and regular advertising considered in determining whether the 3 event 7 day standards of rule Tax 11.10 (3) (a) and (b) are met?

**Question B:** Are the gross receipts of \$1,200 from pizza sales and/or the \$1,000 from advertising considered in determining whether the organization exceeded \$1,000 of gross receipts of "other sales of tangible personal property and services" as stated in rule Tax 11.10 (3) (c) and (d)?

**Question C:** Considering the facts as stated above, does this nonprofit organization qualify for the occasional sales exemption under s. 77.54 (7), Wis. Stats., and rule Tax 11.10, and as a result, does not have to charge sales tax on the sale of beer and restaurant meals at the 3 day festival?

**Answer A:** The sales of frozen pizza and radio advertising are not included in determining whether the organization met the 3 event 7 day standards. Only events involving sales of taxable personal property or services are included in determining whether the 3 event 7 day standards are met.

**Answer B:** The \$1,200 from pizza sales and \$1,000 from radio advertising are not considered "gross receipts" for purposes of determining whether gross receipts exceeded \$1,000 under rule Tax 11.10 (3) (c) and (d). In determining whether gross receipts are \$1,000 or less as stated in rule Tax 11.10 (3) (c) and (d), only receipts from sales of taxable personal property and services are considered "gross receipts". Since the sales of frozen pizza and radio advertising are not subject to Wisconsin sales or use tax, receipts from such sales are not considered "gross receipts" for computing the \$1,000 limit in rule Tax 11.10 (3) (c) and (d).

**Answer C:** The nonprofit organization qualifies for the occasional sales exemption under s. 77.54 (7) and rule Tax 11.10 because it meets all the standards set forth in the law and rule. As a result, the sale of beer and meals at the

3 day festival are not subject to Wisconsin sales or use tax.

#### X. Mover's Sales of Containers

**Facts & Question:** In the Wisconsin Tax Appeals Commission decision of November 23, 1979 in the case of Leicht Transfer & Storage Co., Inc. v. Wisconsin Department of Revenue the Commission held that the corrugated boxes and other containers used by movers may be purchased without tax "for resale" by movers. Thus, the gross receipts from a mover's sales of containers to its customers located in Wisconsin are taxable. Does the tax apply to containers if the Wisconsin customer moves to an out-of-state location as well as moves within Wisconsin?

**Answer:** Yes, the gross receipts from a mover's sales of containers to customers located in Wisconsin are taxable, whether the customer is moving within Wisconsin or to an out-of-state location. The sale takes place at the time the container is delivered to the premises of the customer, whether the customer or the mover packs the container. Sales to persons located in Wisconsin who are moving out-of-state are not exempt sales in interstate commerce under s. 77.54 (1), Wis. Stats.

#### XI. Bakeries - Purchase of Cake Decorations

**Facts & Question:** A bakery purchases edible and nonedible cake decorations which become a component part of the cake. The decoration is physically transferred to the customer with the cake and the customer retains the decoration.

The bakery also purchases reusable items such as cake stands, cake tier dividers and electric fountains. These items are used a number of times by the bakery in satisfying the requirements of customers having weddings or other celebrations. The customer returns these items to the bakery after the wedding or celebration.

**Question A:** Can a bakery purchase without tax edible and nonedible decorations which become a component part of the cake and are transferred to and retained by the customer?

**Question B:** Can a bakery purchase without tax reusable items which are not retained by the customer but are returned to the bakery and used again?

**Answer A:** Since a bakery is considered a manufacturer for sales tax purposes, it can purchase without tax edible and nonedible cake decorations that become a component part of the cake (s. 77.54 (2)). The bakery should give a manufacturing certificate to the person from whom it purchased the edible and nonedible cake decorations.

**Answer B:** If a bakery provides reusable items such as an electric fountain for use at a wedding with no charge to the customer, the sale of the electric fountain to the bakery is subject to the sales tax. The bakery in this instance is considered the consumer of the fountain.

However, if the bakery charges the customer an amount for the use of the electric fountain, the bakery may purchase the electric fountain without tax "for resale" under s. 77.52 (13), Wis. Stats. In this situation, the bakery would impose 4% sales tax on the charge to the customer for using the fountain.