

the property by repaying the loans and enforcing this agreement. The Circuit Court held that Josephine retained the beneficial interest in the properties which were the subject of the deeds of conveyance.

In order that a gift be considered complete for gift tax purposes three things must occur. First, there must be a form of transfer. Second, such transfer must divest the grantor of all

beneficial interest in the property transferred. Third, the grantor must have no power to revest any such interest in herself or her estate. The Circuit Court held that the second and third requirements were not met. The second requirement is absent, because Josephine, the grantor, did not divest herself of all beneficial interest. The third requirement is not met, for this would require that

Josephine had no power to revest any interest in herself or her estate. All parties acknowledged they were bound by the agreement requiring reconveyance to Josephine at such time as she paid the obligations owed to Peter and Anna.

The department has not appealed this decision.

TAX RELEASES

("Tax Releases" are designed to provide answers to the specific tax questions covered, based on the facts indicated. However, the answer 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

1. Prepayment of Mortgage Loan for Discount Considered Income

Facts and Question: A financial institution is offering a discount on the prepayment of a mortgage for certain mortgage customers. In consideration for the advance payment, the financial institution grants a discount on the amount of the prepayment on the mortgage loan. The prepayment and discount are both credited to the mortgage customer's account.

Example: A savings and loan association offers taxpayer a 15% discount on the prepayment of a mortgage loan. Taxpayer prepays \$5,000 on his \$10,000 mortgage and receives a discount of \$750 ($\$5,000 \times 15\%$) for the advance payment. Taxpayer's loan balance is reduced to \$4,250 after applying the prepayment and discount. What is the tax treatment of the \$750 discount?

Answer: Under section 61 (a) (12) of the Internal Revenue Code, gross income is defined as including income from the discharge of indebtedness. Taxable income is realized in situations involving the reduction of indebtedness for advance payment. For both federal and Wisconsin purposes, therefore, the amount of the discount (\$750 in this example) must be included in the taxpayer's income.

Note: Under section 108 of the Internal Revenue Code, gross income does not include income from the discharge of indebtedness if a) the discharge occurs in a Title 11 case, b) the discharge occurs when the taxpayer is insolvent, or c) the indebtedness discharged is qualified business indebtedness. It is assumed in the example above that the taxpayer is solvent and his mortgage pertains to his personal residence, and, therefore, he does not qualify for any of these exceptions.

2. Deductible Municipal Utility Charges Not Property Taxes for Homestead, Farmland Preservation and Property Tax Credits

Facts and Question: Under certain circumstances, Section 164 (c) (1) of the Internal Revenue Code permits real property owners to deduct a portion of charges which they pay to a municipally owned utility as an itemized deduction for property taxes. The amount allowable as an itemized deduction is that portion of the utility charge which the municipality has identified as being attributable to maintenance and interest charges.

Can the portion of a municipal utility charge which a property owner is allowed to claim as an itemized deduction on the federal income tax return be considered as property taxes for purposes of calculating the following Wisconsin credits:

- (1) The 12% property owner's credit provided by s. 71.53, Wis. Stats.
- (2) Homestead credit provided by s. 71.09 (7), Wis. Stats.
- (3) Farmland preservation credit provided by s. 71.09 (11), Wis. Stats.

Answer: No. The statutes which provide the above credits all define property taxes as amounts "exclusive of special assessments, delinquent interest and charges for service..." (emphasis supplied). The statutes do not permit any portion of a charge imposed by a municipal utility for services received by a property owner to be treated as property taxes for purposes of the three credits mentioned above. ("Property taxes" is defined for Homestead Credit purposes in s. 71.09 (7) (a) 8, Wis. Stats., for Farmland Preservation Credit purposes in s. 71.09 (11) (a) 7, Wis. Stats., and for the 12% property owner's credit in s. 71.53 (1) (c), Wis. Stats.)

FARMLAND PRESERVATION CREDIT

1. Converting Initial Farmland Preservation Agreements to Long-Term Agreements

Facts and Questions: Initial farmland preservation agreements entered into under Subchapter III of Chapter 91, Wis. Stats., will expire on September 30, 1982. Sections 71.09 (11) (a) 3.cm and 91.41, Wis. Stats., allow Farmland Preservation Credit claimants to apply for conversion of initial agreements to long-term agreements (under Subchapter II of Chapter 91) by the end of the year in which a certified agricultural preservation plan is

adopted and certified by the county in which the farmland is located.

If a county has not adopted a certified plan by September 30, 1982 but does adopt a plan by December 31, 1982, would the claimant be able to convert the initial agreement to a long-term agreement after September 30, 1982 but before December 31, 1982 and in this way remain eligible to claim farmland preservation credit for 1982?

Answer: No. The initial farmland preservation agreement entered into under Subchapter III of Chapter 91, Wis. Stats., would have expired on September 30, 1982. Effective October 1, 1982, there would be no farmland preservation agreement of any kind in effect to which the provisions of ss. 71.09 (11) (a) 3.cm and 91.41, Wis. Stats., could be applied. Therefore, no farmland preservation credit would be available for 1982 to a claimant under these conditions.

2. Depreciation Add Back for Farmland Credit When Net Operating Loss Sustained

Facts and Question: Beginning with farmland preservation credit claims filed for the taxable year 1981, the law (s. 71.09 (11) (a) 6.a, Wis. Stats.) permits only the first \$20,000 of depreciation claimed in determining Wisconsin adjusted gross income to be recognized in computing household income on a farmland credit claim. In a situation where a claimant has a net operating loss in the year

for which a claim is being filed, how is this depreciation limitation to be applied? (Note: For 1982 taxable year and thereafter the depreciation limitation under s. 71.09 (11) (a) 6.a, Wis. Stats., is \$25,000 rather than \$20,000.)

Example: Mr. X operates a farm and has gross receipts of \$200,000 for 1981. Depreciation of \$35,000 is claimed in 1981 and other farm business expenses are \$185,000 for total expenses of \$220,000. Mr. X therefore computes a net operating loss of \$20,000 for 1981 (\$200,000 less \$220,000=\$20,000 loss). Mr. X has no other income.

Answer: The entire amount of depreciation claimed in the year of loss (1981) must be considered for purposes of applying the \$20,000 depreciation deduction limitation for such year. In the above example, Mr. X would add back \$15,000 (\$35,000 less \$20,000) of depreciation in determining his 1981 household income for Farmland Credit purposes.

When the net operating loss incurred in 1981 is claimed as a carryforward loss by Mr. X in subsequent years, no depreciation will be considered to be a part of such carryforward loss. For purposes of the depreciation add back to household income under s. 71.09 (11) (a) 6.a, Wis. Stats., depreciation claimed in computing a net operating loss is considered *only* in the original year of loss (e.g., 1981 in the above example).