C. Rules Adopted But Not Yet Effective (Effective 11/1/86)

11.001 Definitions and use of terms-A
11.32 "Gross receipts" and "sales price"-A
11.68 Construction contractors-A
11.83 Motor vehicles-A
11.92 Records and record keeping-A
11.95 Retailer's discount-A
11.97 "Engaged in business" in Wisconsin-A

D. Rules Adopted in 1986 (in parentheses is the date the rule became effective)

2.045 Information returns; form 9c for employers of nonresident entertainers, entertainment corporations or athletes-R (1/1/86)
3.22 Real estate and personal property taxes of corporations-R (1/1/86)
3.30 Depreciation and amortization, leasehold improvements: corporations-R (1/1/86)
3.31 Depreciation of personal property of corporations-R (1/1/86)
3.61 Mobile home monthly parking permit fees-R (1/1/86)
11.71 Computer industry-NR (3/1/86)
11.83 Motor vehicles-A (3/1/86)
17.01 Administrative provisions-NR (9/1/86)
17.02 Eligibility-NR (9/1/86)
17.03 Application and review-NR (9/1/86)
17.04 Repayment of loan-NR (9/1/86)

E. Emergency Rules

2.395 Sales factor option-NR

The following sales tax rules to incorporate county sales/use tax provisions were published and became effective on March 24, 1986:

11.001 Definitions and use of terms-A
11.32 "Gross receipts" and "sales price"-A
11.68 Construction contractors-A
11.83 Motor vehicles-A
11.92 Records and record keeping-A
11.95 Retailer's discount-A
11.97 "Engaged in business" in Wisconsin-A

REPORT ON LITIGATION

This portion of the WTB summarizes recent significant Tax Appeals Commission and Wisconsin court decisions. The last paragraph of each decision indicates whether the case has been appealed to a higher court.

The last paragraph of each WTAC decision in which the department's determination has been reversed will indicate one of the following: (1) "the department appealed," (2) "the department has not appealed but has filed a notice of nonacquiescence" or (3) "the department has not appealed" (in this case the department has acquiesced to Commission's decision).

The following decisions are included:

Individual Income Taxes

Corporation Franchise/Income Taxes

Sales/Use Taxes

INDIVIDUAL INCOME TAXES

Domicile — Wisconsin domicile not abandoned. *James Keane vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, June 19, 1986). The sole issue for the Commission to determine was whether the taxpayer during the years 1982 and 1983 was a resident of Racine, Wisconsin and domiciled in this state for income tax purposes.

The taxpayer was employed by the S.C. Johnson Company of Racine, Wisconsin from June 1974 until the present where he is the marketing vice-president, International Division. The taxpayer's home office is located in Racine, Wisconsin.

Prior to his purchase of a condominium in the State of Florida, the taxpayer and his wife resided at 3101 Michigan Road, Racine, Wisconsin. This home was sold in January 1982. The taxpayer testified that he and his wife purchased a condominium located in West Palm Beach, Florida where he took up Florida residency and obtained a Florida driver's license, Florida auto registration, Florida voting registration, Florida bank account and Florida savings account.

The taxpayer also testified that after he and his wife sold their home in Racine, Wisconsin in January 1982, they rented an apartment in Racine, Wisconsin. The taxpayer resided in that apartment approximately 65% of the year.

The taxpayer continued maintaining his Wisconsin driver's license and Wisconsin auto registration. The taxpayer also had personal property located in Wisconsin, maintained a bank account and safety deposit box in Wisconsin, and held membership in the Racine Country Club and St. Mary's Church of Racine, Wisconsin, all during 1982 and 1983.

The taxpayer's wage and tax statement in 1982 and 1983 lists his address as 111 East 11th Street, Racine, Wisconsin, and S.C. Johnson Company withheld Wisconsin state income tax from the taxpayer.

The Commission concluded that the taxpayer, during the period under review, did not abandon his Wisconsin domicile and establish a new domicile elsewhere. During the period under review, the taxpayer was legally domiciled in the State of Wisconsin, and thus, under the provisions of

s. 71.01, Wis. Stats., he was deemed to be residing within this state for the purposes of determining his liability for Wisconsin income taxes. The department's action was proper in imposing a Wisconsin income tax on the taxpayer covering the years 1980 through 1983, inclusive.

The taxpayer has not appealed this decision.

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CORPORATION FRANCHISE/INCOME TAXES

Nexus. *American Brands, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, July 3, 1986). The principal issue for determination was whether the taxpayer was subject to Wisconsin franchise or income tax liability for its fiscal years ended December 31, 1972 through December 31, 1976.

The taxpayer is a New Jersey corporation. Its principal business is the manufacture of tobacco products. For each of the years at issue, the taxpayer held a Certificate of Authority from the State of Wisconsin and filed annual reports with the Secretary of State.

During the years in question, the taxpayer maintained no sales offices in Wisconsin and did not have any employes or independent contractors receiving or accepting orders or making collections in Wisconsin. The taxpayer sold its tobacco products only to licensed distributors such as wholesale jobbers, chain stores, vending machine operators and the United States Government. Customers sent all orders for the taxpayer's tobacco products to the taxpayer's customer service center in Richmond, Virginia. The customer service center accepted, rejected or reduced orders and established credit terms.

The taxpayer stored inventories of tobacco products in two public warehouses in Wisconsin during the period 1963 through December 31, 1976. When processing of orders was completed, instructions were issued from the taxpayer's customer service center in Virginia for the release of the merchandise from the stock of one of such public warehouses or from one of the taxpayer's factories outside Wisconsin, depending on the location of the customer and the brands involved. All shipments to customers in Wisconsin were made by common carrier. During the period at issue, the storage of goods was not an activity protected by P.L. 86-272 from the assertion of Wisconsin franchise or income taxes. The department has conceded that the taxpayer engaged in no activities in Wisconsin, other than storage of goods in public warehouses, which would subject it to Wisconsin franchise/income tax liability.

For tax years prior to 1973, the department did not assert jurisdiction to tax foreign corporations which only maintained inventories in public warehouses from which goods are delivered in the state by common carrier.

In 1971, the Wisconsin Legislature enacted an amendment to Chapter 71 of the Wisconsin Statutes, creating a new statutory apportionment formula patterned after the formula in the Uniform Division of Income for Tax Purposes Act, establishing a three factor formula utilizing property, sales and payroll ratios. As a result of this statutory change, a company in a position such as the taxpayer regarding its activities in Wisconsin, would have a substantially increased tax liability in Wisconsin. The new statutory apportionment formula became effective with the income year 1973.

As a result of the amendment effective in 1973 to Chapter 71, the department began to reconsider its previous policies with regard to "nexus" with foreign corporations. Where previously the revenue which would have been generated by asserting jurisdiction over a foreign company which only maintained inventories in public warehouses in Wisconsin was minimal, under the new apportionment formula the revenue generated would be substantially increased.

The Commission concluded that for the tax years ending December 31, 1972 through December 31, 1974, the department is barred from collecting Wisconsin franchise/income tax from the tax-payer because an assertion of such liability would be beyond the department's administrative authority and an abuse of discretion. For the tax years ending De-ember 31, 1975 and December 31, 1976, the department properly asserted jurisdiction over the taxpayer for franchise/ income tax purposes and the taxpayer is liable for Wisconsin franchise/income tax for that period. The taxpayer has not shown that all the elements of estoppel are present, and therefore, the department is not estopped from asserting jurisdiction over the taxpayer in any of the years at issue.

The department has appealed this decision to the Circuit Court.

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Installment Sales. *Falls Communications, Inc. vs. Wisconsin Department of Revenue* (Court of Appeals, District IV, April 24, 1986). The Wisconsin Department of Revenue appealed from a judgment reversing the Wisconsin Tax Appeals Commission's decision which had upheld the department's assessment of additional income tax against Falls Communications for 1979. The question is whether the transfer of an installment sale obligation by merger of one corporation with another is a "distribution" to the merged corporation under Wis. Adm. Code section Tax 2.19(2).

Falls Communications, a Wisconsin corporation, sold a business asset in 1978. The purchase price was to be paid in installments. Falls Communications reported the sale by the installment method of tax accounting for state tax purposes, as permitted by s. 71.11(8), Wis. Stats.

Falls Communications and C.K. of Tennessee, Inc., a Tennessee corporation, had common shareholders. The corporations and the shareholders approved a plan of merger by which Falls Communications was merged into C.K., effective April 1, 1979. After the merger, C.K. continued to report gain from the 1978 sale by the installment method. The department subsequently made the $20,072.16 assessment at issue on grounds that by the 1979 merger, Falls Communications distributed the installment obligation to C.K. and C.K. therefore lost or did not acquire the right to use the installment method. The department included the remaining unrecognized gain on the installment sale obligation in Falls Communications' taxable income for the year of the merger.

The effect of the merger statutes is such that once the conditions for merger have been met, title to the property of the merged corporation passes to the surviving corporation by operation of law. Nothing more is necessary to accomplish

the passage of title. A corporation merged into another therefore "distributes" nothing to the surviving corporation within the meaning of Wis. Adm. Code section Tax 2.19(2).

The Court of Appeals held that because Falls Communications distributed nothing to C.K., Wis. Adm. Code section Tax 2.19(2) is inapplicable, and the assessment based on that rule is void.

The department has not appealed this decision.

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Interest expense–purchase of own stock. *Luebke Corporation vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, April 2, 1986). Luebke Corporation is a Wisconsin corporation engaged in the manufacture and sale of screw machine products, with its principal offices in Brookfield, Wisconsin. The issue in this case was whether or not the interest paid on the taxpayer's Marine Bank note constituted nondeductible interest paid on money borrowed or interest on notes or securities issued by a corporation to purchase its own capital stock.

On December 14, 1976, the taxpayer purchased and redeemed 162.5 shares of its common stock and 3,905 shares of preferred stock owned by Arthur and Josephine Luebke, representing all of their stock in the corporation, for a total price of $1,500,000. The terms of purchase were $100,000 to be paid at closing on January 6, 1977, together with a promissory note ("the Luebke note") issued by the taxpayer in the amount of $1,400,000, providing for quarterly payments of interest and principal for a 15-year period. Payments of interest and principal were made during 1977 and in early 1978.

The effect of this redemption was to place the taxpayer's ownership fully in the hands of the remaining shareholders, Dane and Gregory Luebke, sons of Arthur and Josephine Luebke.

In the minutes of the taxpayer's board of directors meeting on May 12, 1978, the directors expressed concern about impairment in the operations of the business resulting from the security arrangements underlying the Luebke note. It was indicated that the South Milwaukee Marine Bank would be willing to loan up to $1,300,000 at a 10% interest rate to provide the funds for the purpose of prepaying the Luebke note. Accordingly, resolutions were adopted to (1) prepay the Luebke note including a $50,000 prepayment penalty; (2) borrow the sum of $1,300,000 from the South Milwaukee Marine Bank; and (3) authorize and direct the corporate officers to execute all documents reasonable and necessary to effect prepayment and consummate the loan transaction at the bank. In the same minutes the directors adopted resolutions to purchase a machine for approximately $194,000 and certain equipment for $1,000,000.

The taxpayer proceeded to obtain the $1,300,000 loan ("the Marine note") on June 15, 1978, secured by a first mortgage on corporate real estate, a general business security agreement, 325 shares of corporate stock, certain life insurance policies, and personal guarantees of the stockholders. Of the amount borrowed, $1,252,483.34 was directly applied to satisfaction of the Luebke note, $13,068 to loan and title insurance fees, and $34,448.66 was deposited in the corporate checking account available for general business purposes.

On its Wisconsin franchise tax returns for the fiscal years ending July 1, 1978, June 30, 1979 and June 28, 1980, filed on the accrual basis of accounting, the taxpayer deducted interest accruals on the Marine note.

The department disallowed the Marine note interest based upon its conclusion that the interest was "paid on money borrowed or interest on notes and securities issued by a corporation to purchase its own capital stock" and was, therefore, not deductible by operation of s. 71.04(2)(a)3, Wis. Stats. The disallowance was prorated to allow that portion of the interest reflecting 2.65% of loan proceeds that went into the taxpayer's general checking account. Interest paid on the Luebke note was also disallowed under that provision, an adjustment which the taxpayer conceded was proper and did not contest administratively.

There is no evidence that the taxpayer could have satisfied the Luebke note at the time it did, on June 15, 1978, from corporate funds *then* available without substantial borrowing. The only specific reason for prepayment set forth in the corporate minutes was "the impairment in the operations of the business which had resulted from the security interest of Arthur J. and Josephine Luebke in the corporation's property, and inability to obtain desired consents and waivers under the security arrangements."

The term as well as the interest rate of the Luebke note was more favorable than the Marine note. The impairment to the taxpayer's business operations occasioned by the Luebke note security and waiver provisions was evidently of sufficient magnitude to move the corporation to act when it did to satisfy that note by borrowing funds from the South Milwaukee Marine Bank rather than wait until funds were generated from business operations. The Marine note funds were borrowed for the purpose of paying off the Luebke note.

The Commission held that the interest on the Marine bank loan was paid on money borrowed by the taxpayer to purchase its own capital stock and was, therefore, nondeductible under s. 71.04(2)(a)3, Wis. Stats.

The taxpayer has not appealed this decision.

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Net business loss carryforward. *Regency Nursing Home, Inc. vs. Wisconsin Department of Revenue* (Circuit Court of Milwaukee County, April 29, 1986). Regency Nursing Home petitioned for review of the decision and order of the Wisconsin Tax Appeals Commission dated November 13, 1984. That decision upheld the Wisconsin Department of Revenue when the latter denied the taxpayer's carryforward of certain existing business losses. Thus, the issue was whether or not the Commission correctly decided that the gain from the sale of the business does not constitute "net business income" as that term is defined in s. 71.06, Wis. Stats., so that the prior net business losses may not be used as an offset. (See WTB 41 for a summary of the Wisconsin Tax Appeals Commission's decision.)

The Circuit Court concluded that the ongoing operation of a particular business is essential in order to utilize the subject gain as "net business income" against which to offset a "net business loss." The Court therefore found that the Commis-

sion did not err and correctly applied the law. The Court further found that the Commission correctly determined that it did not have the authority to review the taxpayer's additional arguments which were raised for the first time in its petition for redetermination. The Circuit Court was likewise without the authority to do so by virtue of s. 227.20(1), Wis. Stats.

The taxpayer has appealed this decision to the Court of Appeals.

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SALES/USE TAXES

Meals—transportation companies, gross receipts. *Bargo Foods North, Inc. and Republic Airlines vs. Wisconsin Department of Revenue* (Circuit Court of Dane County, March 13, 1986). The matter before the Court was an appeal from an assessment made by the department for additional sales and use taxes against Bargo Foods North, Inc. (Bargo) for the years 1978 through 1981. Bargo is a catering company providing food and beverage kits at Mitchell Field in Milwaukee to commercial airlines for in-flight use. The sales tax assessment is for meals that the taxpayer sold to Republic Airlines (Republic) at Mitchell Field. Republic has an indemnification agreement with Bargo regarding this sales tax assessment. Bargo and Republic brought this appeal from a decision and order of the Wisconsin Tax Appeals Commission, dated October 2, 1985, affirming the department's assessment.

The Commission determined that Bargo's sale of meals to Republic was subject to Wisconsin's sales tax; that this transaction was not a sale for resale exempt from sales tax; and that Bargo's sale to Republic was for use or consumption, not for a subsequent transfer for valuable consideration.

Further, the Commission determined that the fee Bargo paid Milwaukee County for the right to operate at Mitchell Field, 8% of Bargo's total gross receipts, was not a tax and therefore was not deductible from Bargo's gross receipts under s. 77.51(11)(a)4, Wis. Stats. Bargo passed this user fee along to Republic as part of its total gross receipts. (See WTB 45 for a summary of the Wisconsin Tax Appeals Commission's decision.)

The Circuit Court concluded that Bargo's sales of meal kits to Republic at Mitchell Field were not sales for resale. Republic provided meals to passengers as a commercial amenity, not for valuable consideration; therefore, Bargo's sales to Republic were taxable transactions. The Wisconsin Department of Revenue properly assessed the sales tax for these transactions. Further, Bargo is not entitled to a deduction on its assessment for airport charges paid to Milwaukee County; this was not a tax on a tax.

The taxpayer has appealed this decision to the Court of Appeals.

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Successor's liability. *Reichard Yamaha, Inc. vs. Wisconsin Department of Revenue* (Circuit Court of Dane County, July 7, 1986). The taxpayer raised two issues:

A. Is the taxpayer a successor and therefore subject to sales tax liability under s. 77.52(18), Wis. Stats.?

B. If so, did the department comply with Administrative Code requirements that it first proceed against Classic Motorcycles, Inc. before assessing the taxpayer with tax liability?

Reichard Yamaha, Inc. is a motorcycle sales and service business. In June 1982, the taxpayer was asked to purchase the business and/or assets of Classic Motorcycles, Inc. (Classic), another motorcycle sales and service business located in Cudahy, Wisconsin. The taxpayer declined the offer. The taxpayer later learned that Classic had begun the process of liquidating its business. In July 1982, the taxpayer purchased certain accessories, parts and office equipment from Classic. The items purchased represented only a portion of the total inventory of Classic. The taxpayer later occupied the premises vacated by Classic. It used its own name, Reichard Yamaha, at the new location. It obtained its own phone number, occupancy permit and motor vehicle permit. It did not obtain receivables, customer lists or payables from Classic. Nor did it honor obligations for warranty work for customers of Classic.

The Circuit Court concluded that the taxpayer is a successor, as that term is used in s. 77.52(18), Wis. Stats. The Court remanded the case to the Wisconsin Tax Appeals Commission for further fact-finding on the department's collection efforts relative to Classic and its former officers.

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Definitions of storage and use, liability of user. *Wisconsin Bell, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, April 14, 1986). The issues in this case were as follows:

A. Whether the taxpayer stored, used or otherwise consumed telephone directories partially completed in this state and printed in another state, delivered to the taxpayer's agent in this state for distribution to the taxpayer's customers.

B. Whether the taxpayer is liable for use tax on tangible personal property purchased for its own use in Wisconsin from vendors subject to Wisconsin sales and use tax laws, where the department is unable due to statutes of limitation to audit the vendors and collect sales or use tax.

The Commission held as follows:

A. For sales and use tax purposes, upon delivery by the printer to the taxpayer's agent for receipt, warehousing, and distribution, Directory Distributing Associates, Inc., the taxpayer owned and possessed the telephone directories in Wisconsin. The taxpayer's ownership and possession of the directories in Wisconsin together with its exercise of rights and powers over them in Wisconsin constituted "use" as defined in s. 77.51(15), Wis. Stats. The warehousing of the directories in Wisconsin by the taxpayer's agent constituted "storage" as defined in s. 77.51(14), Wis. Stats. The taxpayer having engaged in both "storage" and "use" of the directories in Wisconsin was subject to use tax measured by the printing and transportation charges from the printer.

B. The taxpayer was liable for use tax on its purchases of various tangible personal property from Wisconsin vendors and non-Wisconsin vendors holding Wisconsin seller's permits or such vendors doing business as retailers in Wisconsin for use in Wisconsin. The taxpayer's liability for use tax was not extinguished absent evidence that the sales or use tax has been

paid to the state, or a receipt from a retailer with the tax separately stated. The department's assessment of use tax against the taxpayer rather than the sales tax against the various vendors is permitted by law and is fair and proper. The taxpayer has not appealed this decision.

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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.)

The following Tax Releases are included:

Individual Income Taxes

Income and Franchise Taxes

Corporation Franchise/Income Taxes

INDIVIDUAL INCOME TAXES

1. Basis and Depreciation Allowable for Property Located Outside Wisconsin Acquired by an Individual Before Becoming a Wisconsin Resident

Statutes: Sections 71.02(2)(c), (d) and (i) and 71.05(1)(m), 1985 Wis. Stats.

Wis. Adm. Code: Section Tax 2.30, July 1982 Register

Question: If a nonresident individual acquires and places in service depreciable property located outside Wisconsin, what is the Wisconsin basis and what depreciation method is allowable for Wisconsin purposes when this individual becomes a Wisconsin resident?

Answer:

A. If Federal Basis and Federal Depreciation Are Determined in a Manner Allowable Under the Internal Revenue Code in Effect for Wisconsin

The Wisconsin basis of the property is the same as the federal basis, provided the federal basis was determined under the Internal Revenue Code in effect for Wisconsin for the taxable year in which the individual becomes a Wisconsin resident. Also, depreciation for Wisconsin purposes is the same as the federal depreciation, provided the federal depreciation method is allowable under the Internal Revenue Code in effect for Wisconsin for the taxable year in which the individual becomes a Wisconsin resident.

Example: Taxpayer A became a Wisconsin resident on January 1, 1985. Prior to that date, he had been an Illinois resident. On July 1, 1984, Taxpayer A had purchased and placed in service rental property located in Illinois. The cost of the property, not including the land, was $200,000.

On his 1984 federal return, Taxpayer A claimed $8,000 of depreciation on this rental property, computed using the 18-year ACRS recovery period. The federal adjusted basis of the property on January 1, 1985 is $192,000 ($200,000 cost – $8,000 depreciation allowable). (The Tax Reform Act of 1984 provided that for real property placed in service after March 15, 1984, the ACRS recovery period was increased from 15 to 18 years.)

On his 1985 federal return, Taxpayer A claims $18,000 of depreciation on this rental property.

Since Wisconsin has adopted the Internal Revenue Code as of December 31, 1984 for the 1985 taxable year, the Wisconsin basis of the property on January 1, 1985 is the same as the federal basis, $192,000. To compute the depreciation allowable for Wisconsin for 1985, Taxpayer A uses the same basis and depreciation method that he is using for federal purposes. Thus, his 1985 Wisconsin depreciation is $18,000, the same as his 1985 federal depreciation.

Note: For Wisconsin purposes, the taxpayer may elect to recompute both the basis and the depreciation using another method allowable under the Internal Revenue Code in effect for Wisconsin instead of using the federal basis and federal depreciation method. For instance, in the above example Taxpayer A may elect to use the alternate ACRS method for Wisconsin with an 18-year recovery period. Under this method, the 1984 deprecia-