expenses can vary significantly from case to case and client to client, Frisch elected to include these charges in its itemization of out-of-pocket costs and disbursements, billing them separately from the legal fees, in order to fairly distribute the costs among all clients. Copies billed to clients represent roughly one-half of all copies made by the firm. The billed copies are those made for opposing counsel, courts, government agencies, and for the firm's own internal use. The clients themselves receive only a small portion of the billed copies. All decisions on photocopy billing are made by the attorney handling the case.

Only a very few copies ever find their way to the client, and when they do, it is only as an incident to their use in the firm's representation of the client. In addition, the copies are not "produced ... to the special order of the [client]"; the decision to copy is the firm's alone.

The Court of Appeals concluded the firm was not a "retailer" of photocopies and thus no sales tax may be imposed on its client photocopying charges under s. 77.52(1), Wis. Stats., and in doing so affirmed the order of the Circuit Court.

The department 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

1. Interest Received from Community Development Authority Bonds
2. Manufacturer's Sales Tax Credit Allowable to Shareholders of Tax-Option (S) Corporations
3. Wisconsin Tax Treatment of Section 1256 Contracts

Sales/Use Taxes

1. Voice Messaging Business (Gross Receipts and Purchases)

INDIVIDUAL INCOME TAXES

1. Interest Received From Community Development Authority Bonds

Statutes: Section 71.05(1)(a)1, 1985 Wis. Stats.

Background: Wisconsin Administrative Code section Tax 3.095 (4) provides that interest received from public housing authority bonds of Wisconsin municipalities is exempt from Wisconsin income tax. However, public housing authorities no longer exist upon the adoption of an ordinance creating a community development authority, as a result of Chapter 273, Laws of 1967 (s. 66.4325(1), 1985 Stats.). In creating the community development authorities, the legislature made no provision in Chapter 66, Wis. Stats., that interest received from bonds issued by community development authorities would be tax exempt.

Facts and Question: 42 U.S.C. Section 1437i(b) exempts from federal income tax interest issued by public housing authorities, defined as any state, county, municipality or other governmental entity or public body which is authorized to engage in or assist in the development or operation of low income housing.

In addition, Federal Revenue Ruling 82-56 states interest paid on bonds issued by municipal housing authorities that are exempt from federal income taxation under 42 U.S.C. Section 1437i(b) is excluded from the gross income of the bondholders without regard to the provisions of Section 103 of the Internal Revenue Code, relating to interest from government obligations.

Is interest received from a bond issued by a community development authority taxable for Wisconsin income tax purposes under s. 71.05(1)(a)1, 1985 Wis. Stats.?

Answer: Section 71.05(1)(a)1, 1985 Wis. Stats., provides an add back modification of any state or municipal interest excluded from federal income by reason of Section 103 of the Internal Revenue Code. However, Revenue Ruling 82-56 provides that community development bond interest received is excluded from federal income *without* regard to IRC Section 103. Therefore, the interest received from bonds issued by a community development authority, which is excluded from federal income under 42 U.S.C. Section 1437i(b), is not taxable for Wisconsin because there is no add back modification provided for in s. 71.05(1)(a), 1985 Wis. Stats.

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2. Manufacturer's Sales Tax Credit Allowable to Shareholders of Tax-Option (S) Corporations

Statutes: Section 71.043, 1985 Wis. Stats.

Facts: Section 71.043(2), 1985 Wis. Stats., states: "The tax imposed upon or measured by corporation net income ... pursuant to s. 71.01(1) or (2) may be reduced by an amount equal to the sales and use tax under ch. 77 paid by the corporation in such taxable year on fuel and electricity consumed in manufacturing tangible personal property in this state." In addition, s. 71.043(3) provides in part that "such credit, to the extent not offset by the tax liability of the same year may be offset against the tax liability of the subsequent year." A credit, to the extent not used, may be carried forward 15 years.

In *Wisconsin Department of Revenue v. Edwin F. Gordon*, 127 Wis. 2d 71 (1985), the Court of Appeals held that "the portion of Gordon's personal income tax that is measured by the net income of the tax-option corporation can be reduced by an amount equal to the corporation's tax credit under ch. 77, Stats."

Question 1: What is included in a shareholder's share of the net income of a tax-option (S) corporation?

For example, a shareholder receives the following income from a tax-option (S) corporation:

Salary	$30,000
Interest on loan to the corporation	1,000
Taxable dividend of pre-1979 earnings	3,000
Rent from assets leased to the corporation (after deducting rental expenses, the shareholder incurs a $2,500 loss)	5,000
Distributive share of tax-option corporation net income (based on line 25 of 1986 Wisconsin Form 4)	15,000

Answer 1: The shareholder's share of the net income from the tax-option (S) corporation which may be used to compute his or her allowable manufacturer's sales tax credit is $15,000, the distributive share of tax-option corporation net income from line 25, 1986 Wisconsin Form 4.

Question 2: May a credit for 1980 which could have been used in that year but was not claimed because the year was closed to adjustment at the time the *Gordon* decision was issued, be carried forward to 1981 and subsequent years?

For example, a shareholder's share of a tax-option (S) corporation's 1980 manufacturer's sales tax credit was $2,500. The shareholder followed Department of Revenue instructions and did not claim any portion of this credit on his or her 1980 Wisconsin Form 1. The shareholder's 1980 personal income tax measured by tax-option corporation net income was $750.

Answer 2: Yes, the shareholder may carry forward to 1981 and subsequent years the entire $2,500 credit because no part of the credit was actually used in 1980.

Question 3: May a tax-option (S) corporation pass through to its shareholders unused manufacturer's sales tax credits from years in which the corporation had been a regular C corporation?

For example, a corporation was a C corporation for the 1983 through 1985 taxable years. In each of these years, the corporation incurred a loss. At the beginning of its 1986 taxable year, the corporation had $2,000 of unused manufacturer's sales tax credits from its 1983 through 1985 taxable years. The corporation elects subchapter S status effective for its 1986 taxable year. For 1986, the corporation has net income of $50,000 and a manufacturer's sales tax credit of $750.

Answer 3: Yes, a tax-option (S) corporation may pass through to its shareholders unused manufacturer's sales tax credits from C corporation years. In the example, the corporation may pass through the $2,000 of unused manufacturer's sales tax credits from its 1983 through 1985 taxable years, in addition to the $750 credit from its 1986 taxable year.

Question 4: May a tax-option (S) corporation elect not to pass through the manufacturer's sales tax credit to the shareholders, and instead, use the credit itself in a year when the corporation returns to C corporation status?

Answer 4: Yes, a tax-option (S) corporation may elect whether or not to pass the manufacturer's sales tax credit through to its shareholders. However, only so much of the manufacturer's sales tax credit is passed through to the shareholders as is needed to offset the tax on the tax-option (S) corporation income. The rest of the credit is retained by the corporation and may be carried forward for use by the shareholders or by the corporation if it returns to C corporation status.

Example 1: A tax-option (S) corporation incurred losses for 1980 through 1985 which were passed through to the shareholders. Although the corporation had a manufacturer's sales tax credit available for each of these years, the shareholders didn't receive a benefit from these credits. If the corporation revokes its subchapter S election effective for the 1986 taxable year, the corporation may carry forward the credits from 1980 through 1985 and claim them on its 1986 corporation franchise/income tax return.

Example 2: A tax-option (S) corporation had income for 1985 which it passed through to the shareholders. The manufacturer's sales tax credit available for 1985 exceeded the shareholders' individual Wisconsin income tax liabilities on the tax-option (S) corporation income. If the corporation revokes its subchapter S election effective for the 1986 taxable year, the corporation may carry forward the unused portion of the 1985 credit and claim it on the corporation's 1986 franchise/income tax return.

Example 3: The stock of a Wisconsin tax-option (S) corporation is held by nonresident shareholders, none of whom file Wisconsin income tax returns because their income is below the filing requirement. If the corporation revokes its subchapter S election, the corporation may claim the unused manufacturer's sales tax credits.

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3. Wisconsin Tax Treatment of Section 1256 Contracts

Statutes: Section 71.02(2)(d)8, 9 and 11, 1985 Wis. Stats.

Background - Federal Law: The Economic Recovery Tax Act of 1981 (P.L. 97-34) added Internal Revenue Code Section 1256, which provided that all regulated futures contracts must be marked-to-market at year end. The Technical Corrections Act of 1982 (P.L. 97-448) provided that the term "regulated futures contract" includes foreign currency contracts.

The Tax Reform Act of 1984 (P.L. 98-369) extended the mark-to-market rule to nonequity options and dealer equity options. In addition, the Tax Reform Act of 1984 designated regulated futures contracts, foreign currency contracts, nonequity options

and dealer equity options, which are defined in Internal Revenue Code Section 1256(g), as "Section 1256 contracts."

Under the mark-to-market rule, each Section 1256 contract is treated as if it were sold for fair market value on the last business day of the taxable year. Any gain or loss on the contract is included in income for the taxable year, together with the gain or loss on other contracts which were held during the year but closed out before the last business day. In the year these contracts are settled, the taxpayer must adjust the gain or loss actually realized on these contracts to reflect any gain or loss taken into account with respect to the contracts in a prior year.

Any capital gain or loss on a Section 1256 contract which is marked-to-market is treated as if 40% of the gain or loss is short-term capital gain or loss and 60% is long-term capital gain or loss.

In addition, the Economic Recovery Tax Act of 1981 added Internal Revenue Code Section 1212(c), which provided that net commodity futures capital losses may be carried back three years and applied against net commodities futures capital gains during such period. The Tax Reform Act of 1984 extended this treatment to all net Section 1256 contract losses and gains.

The carryback applies only if, after netting Section 1256 contracts and other positions subject to the mark-to-market rule with capital gains and losses from other sources, there is a net capital loss for the taxable year which, but for the election, would be a capital loss in the succeeding year. The lesser of such net capital loss or the net loss resulting from the application of the mark-to-market rule constitutes a net Section 1256 capital loss which may be carried back.

The amount carried back may be applied only against net gains resulting from application of the mark-to-market rule in the carryback year. The gains must be reduced by any net capital loss to which the mark-to-market rule did not apply in the carryback year, so that only to the extent the taxpayer had a net gain in the carryback year would any portion of the loss be allowed.

Amounts carried back under this election are treated as if 40% of the losses are short-term capital losses and 60% are long-term capital losses. The losses must be absorbed in the earliest year to which they may be carried back and any remainder is then carried forward to the next year in the same proportions of 40% and 60%. Losses are not allowable to the extent they would create or increase a net operating loss in the carryback year.

For federal income tax purposes, the changes made by the Economic Recovery Tax Act of 1981 relating to regulated futures contracts were generally effective for property acquired and positions established after June 23, 1981, in taxable years ending after that date. However, taxable year 1981 was the earliest year to which net commodity futures capital losses could be carried back.

Federally, the law change made by the Technical Corrections Act of 1982 relating to foreign currency contracts generally applied with respect to contracts entered into after May 11, 1982.

Finally, for federal income tax purposes, the changes made by the Tax Reform Act of 1984 relating to nonequity options and dealer equity options are generally effective for positions established after July 18, 1984, in taxable years ending after that date.

Question 1: Does Wisconsin follow the federal mark-to-market rule for regulated futures contracts?

Answer 1: Yes. Section 71.02(2)(d)8, 1985 Wis. Stats., provides that for the 1982 taxable year Wisconsin follows the Internal Revenue Code in effect on December 31, 1981. Beginning with the 1982 taxable year, regulated futures contracts must be marked-to-market for Wisconsin income tax purposes. Any capital gain or loss is treated as if 40% of the gain or loss is short-term capital gain or loss and 60% is long-term capital gain or loss.

Question 2: Does Wisconsin permit the three-year carryback of net commodity futures capital losses?

Answer 2: Yes. Pursuant to s. 71.02(2)(d)8, 1985 Wis. Stats., net commodity futures capital losses may be carried back three years and applied against net commodities futures capital gains during such period. For Wisconsin income tax purposes, taxable year 1982 is the earliest year to which net commodities futures capital losses may be carried back.

Question 3: Does Wisconsin follow the federal treatment for foreign currency contracts?

Answer 3: Yes. Beginning with the 1983 taxable year, the federal treatment of foreign currency contracts applies for Wisconsin income tax purposes [s. 71.02(2)(d)9, 1985 Wis. Stats.].

Question 4: Does Wisconsin follow the federal mark-to-market rule for nonequity options and dealer equity options and permit the three-year carryback of net Section 1256 contract losses?

Answer 4: Yes. Section 71.02(2)(d)11, 1985 Wis. Stats., provides that for the 1985 taxable year Wisconsin follows the Internal Revenue Code in effect on December 31, 1984. Beginning with the 1985 taxable year, nonequity options and dealer equity options must be marked-to-market for Wisconsin income tax purposes. Any capital gain or loss is treated as if 40% of the gain or loss is short-term capital gain or loss and 60% is long-term capital gain or loss.

Additionally, net Section 1256 contract losses may be carried back three years and applied against net Section 1256 contract gains. For Wisconsin income tax purposes, taxable year 1985 is the earliest year to which net losses from nonequity options and dealer equity options may be carried back.

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SALES/USE TAXES

1. Voice Messaging Business (Gross Receipts and Purchases)

Statutes: Sections 77.52(2)(a)4 and 77.54(24), 1985 Wis. Stats.

Wis. Adm. Code: Sections Tax 11.66(1)(c), January 1983 Register and 11.71(3)(a) and (d), February 1986 Register

Facts and Question: An EVX Office Message System computer is located in the office of this service provider, and customers gain access to the computer by using any touch-tone telephone. The service provider describes the business as voice messaging, a new technology. The service is available 24 hours a day and a customer deposits or retrieves telephone messages by using a national 800 number or local access. Customers using the taxpayer's 800 number are required to pay by the minute for the use of the company's circuits.

An advertising brochure indicates voice messaging may be (a) used as a message center, (b) used as a call forwarding service, or (c) used as an answering service. Messages are stored in the computer and the service allows the customer to send or retrieve messages, reply to a message directly, save selected messages, cancel messages no longer needed, redirect or reroute message to other users or broadcast group messages with group distribution codes.

(a) Is this voice messaging service a taxable telephone service under s. 77.52(2)(a)4, 1985 Wis. Stats.?

(b) Is this service provider required to pay sales tax on its purchases of equipment and telephone circuits (800 numbers) used to provide voice messaging service?

Answer: (a) This voice messaging business is not engaged in providing telephone services to its customers which are taxable under s. 77.52(2)(a)4, 1985 Wis. Stats. Mechanical or non-mechanical telephone answering services, providing messages by computer and call forwarding services are not taxable under s. 77.52(2)(a)4, 1985 Wis. Stats, when provided as part of a voice messaging business.

(b) The taxpayer's purchases of equipment are taxable because it is not a "telephone company," which is a requirement to obtain a sales/use tax exemption provided under s. 77.54(24), 1985 Wis. Stats., for equipment used in transmitting traffic and operating signals. The company's purchases of telephone services are also taxable because the telephone circuits, which consist of 800 numbers, provided to certain customers located outside the local calling area are used incidentally in providing its nontaxable voice messaging service.

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