

HOMESTEAD CREDIT

Property taxes accrued—joint ownership. *Myrtle Berglin vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, January 26, 1987). The issue pending before the Commission is whether the department was correct in making the adjustment to the amounts allowed for property taxes accrued and rent constituting property taxes accrued for the claimant's 1985 homestead credit claim.

During the entire year of 1985, Myrtle L. Berglin and Gustav Berglin (her brother) were listed on the title to the real estate located at 921 Ellis Avenue, Ashland, Wisconsin 54806, as the owners of record in joint tenancy. This property is the property on which the claimant's homestead credit claims are based. The real estate tax bills

for the homestead for the year in question show the property owners as Myrtle and Gustav Berglin. The claimant paid all of the real estate taxes on the real property during the period in question.

In the notice explaining the adjustment in the amount of the claimant's 1985 homestead credit claim, the department adjusted the amount shown on the homestead credit claim form for taxes and rent paid by reducing the property tax amount to one-half of the net general tax paid. The department also allowed the claimant to claim an additional 25% of the real estate taxes paid as rent constituting property tax accrued for 1985 because Gustav Berglin did not reside in the homestead.

The Commission concluded that during the period under review, the claimant was

deemed to have an ownership interest of only 50% in the homestead in question, as record title to the homestead was held jointly by her with her brother. Even though the claimant paid the entire 1985 property tax bill, as one of the two joint owners on the homestead, under the provisions of s. 71.09(7)(a)8, Stats., she was entitled to claim as her 1985 property taxes accrued only 50% of the 1985 taxes, rather than 100% of the 1985 taxes. The department acted properly when it adjusted the claimant's 1985 property taxes accrued to 50% of the tax bill on the homestead plus 25% of the remaining 50% of the 1985 tax bill as rent constituting property taxes accrued.

The claimant 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.)

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INDIVIDUAL INCOME TAXES

1. Limitations on Farm Losses

Statutes: Section 71.05(1)(a)26, 1985 Wis. Stats.

Note: This Tax Release applies only with respect to taxable years 1986 and thereafter.

Background: Section 71.05(1)(a)26 was created by 1985 Wisconsin Act 29. The new add modification limits the amount of combined net losses, exclusive of net gains, from farming businesses which may be claimed on the Wisconsin income tax return. Losses under sections 1211 (capital losses) and 1231 (loss on the sale or other disposition of property used in a trade or business) of the Internal Revenue Code are disregarded. Farm losses will be added back to arrive at Wisconsin taxable income to the extent:

- a) farm losses are greater than \$20,000 if nonfarm Wisconsin adjusted gross income is greater than \$55,000 but not greater than \$75,000, or
- b) farm losses are greater than \$17,500 if nonfarm Wisconsin adjusted gross income is greater than \$75,000 but not greater than \$100,000, or
- c) farm losses are greater than \$15,000 if nonfarm Wisconsin adjusted gross income is greater than \$100,000 but not greater than \$150,000, or
- d) farm losses are greater than \$12,500 if nonfarm Wisconsin adjusted gross income is greater than \$150,000 and not greater than \$200,000, or

- e) farm losses are greater than \$10,000 if nonfarm Wisconsin adjusted gross income is greater than \$200,000 and not greater than \$250,000, or
- f) farm losses are greater than \$7,500 if nonfarm Wisconsin adjusted gross income is greater than \$250,000 and not greater than \$300,000, or
- g) farm losses are greater than \$5,000 if nonfarm Wisconsin adjusted gross income is greater than \$300,000 and not greater than \$400,000, or
- h) farm losses are greater than \$0 if nonfarm Wisconsin adjusted gross income is greater than \$400,000.

Facts and Question 1: Losses are limited if they are incurred in the operation of a farming business. What is considered "farming"?

Answer 1: Section 71.05(1)(a)26, 1985 Wis. Stats., states that farming is defined in section 464(e)1 of the Internal Revenue Code. Under this section of the Code, "farming" means:

"the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity including the raising, shearing, feeding, caring for, training, and management of animals. For purposes of the preceding sentence trees (other than trees bearing fruit or nuts) shall not be treated as an agricultural or horticultural commodity."

Facts and Question 2: Will the farm loss rules apply to Christmas tree farms whereby every year there is a Schedule F loss pursuant to an election under section 631(a) of the Internal Revenue Code creating an offsetting (and related) gain on federal Schedule 4797?

Answer 2: No. Section 71.05(1)(a)26, 1985 Wis. Stats., provides that farming is defined in IRC section 464(e)(1) for purposes of applying the farm loss limitations. Section 464(e)(1) states that farming does not include raising or harvesting trees other than fruit or nut-bearing trees. Therefore, raising or harvesting of Christmas trees is not considered farming and the losses from such activities are not limited.

Facts and Question 3: In determining net losses incurred in the operation of a farming business for purposes of s. 71.05 (1)(a)26, 1985 Wis. Stats., do net losses include only those amounts that are properly reportable on federal Schedule F?

Answer 3: No. A part of the net loss from farming may be reported somewhere other than on Schedule F. For example, a gain or loss from a raised dairy calf that is less than 2 years old would be reported in Part 2 of 1986 federal Form 4797 and carried directly to line 15 of a sole proprietor's 1986 federal Form 1040 (a raised dairy calf that is less than 2 years old is not a section 1231 asset and thus should be included in computing the net farm loss). Also, a net loss from farming received by a partner, a shareholder in an S corporation, or a beneficiary of an estate or trust is reported on federal Schedule E.

Facts and Question 4: Assume a Wisconsin farmer has the following income and loss for 1986:

Nonfarm Wisconsin adjusted gross income	\$ 60,000
Schedule F, net farm loss	\$(450,000)*
Interest income on funds held to provide capital for farm expenditures	\$ 5,000

*Includes interest expense of \$1,000 on loans taken out to provide capital for farm expenditures.

How is the add modification under s. 71.05(1)(a)26, 1985 Wis. Stats., computed?

Answer 4: The s. 71.05(1)(a)26, 1985 Wis. Stats., add modification is calculated as follows:

Schedule F loss	\$(450,000)
Related interest income	5,000
Combined net losses from a farm business	\$(445,000)
Amount allowed under s. 71.05(1)(a)26, 1985 Wis. Stats.	20,000
Add modification	<u>\$(425,000)</u>

The interest income and interest expense are included in computing the net loss from farming since they arose in the regular course of the taxpayer's farm business. Interest income that may be considered as income arising in the regular course of the taxpayer's farm business includes interest from a NOW checking account used for farm business and interest on money held for a down payment on farm equipment.

Facts and Question 5: A taxpayer has wages of \$60,000 and a Schedule F farm loss of \$40,000 in 1986. Also in 1986, the taxpayer sold his farm on a land contract and received interest income in regard to the sale of \$20,000. This was the only farm the taxpayer operated. The taxpayer sold the farm to get out of the business of farming. Is the interest income considered farm-related income that may be used to compute the combined net losses from a farm business under s. 71.05(1)(a) 26, 1985 Wis. Stats?

Answer 5: No. The interest income received by the taxpayer in 1986 is considered to be nonfarm income. There is no farm business purpose in regard to the sale because the taxpayer is getting out of the farming business. The taxpayer is required to make an add modification of \$22,500 (\$40,000 Schedule F farm loss minus \$17,500 loss limit) because nonfarm adjusted gross income is greater than \$75,000 but not greater than \$100,000.

Facts and Question 6: Assume the same facts as in Question 5 except that the taxpayer operates two farms. Because the taxpayer was experiencing economic problems, he sold one farm in order to obtain the operating capital necessary to continue operating the other farm. Is the interest income considered farm-related income that may be used to compute the combined net losses from a farm business under s. 71.05(1)(a)26, 1985 Wis. Stats.?

Answer 6: Yes. The interest income is considered to be farm-related income. The Schedule F farm loss of \$40,000 minus farm-related interest income of \$20,000 is not greater than \$20,000; therefore, the taxpayer is not subject to the farm loss limitation rules.

Facts and Question 7: Assume a Wisconsin farmer has the following income and losses for 1986:

Nonfarm Wisconsin adjusted gross income	\$ 60,000
Farm #1- S Corporation	\$(500,000)
Farm #2- Schedule F, net farm profit	\$ 200,000
Farm #3- Partnership	\$ (35,000)

How is the add modification under s. 71.05(1)(a)26, 1985 Wis. Stats., computed?

Answer 7: The s. 71.05(1)(a)26, 1985 Wis. Stats., add modification is calculated as follows:

Farm #1 loss	\$(500,000)
Farm #3 loss	(35,000)
Combined net losses from a farm business	<u>\$(535,000)</u>
Amount allowed under s. 71.05(1)(a)26, 1985 Wis. Stats.	20,000
Add modification	<u>\$(515,000)</u>

The losses from Farms #1 and #3 are not reduced by the amount of net profit from Farm #2 because the law provides for a modification for combined net losses, exclusive of gains.

Facts and Question 8: Assume the same facts as in Question 7. What is the taxpayer's Wisconsin adjusted gross income?

Answer 8: The taxpayer's Wisconsin adjusted gross income is computed as follows:

Federal adjusted gross income	\$(275,000)
Wisconsin add modification	<u>515,000</u>
Wisconsin adjusted gross income	\$ 240,000

Facts and Question 9: A Wisconsin farmer has the following income and losses for 1986:

Nonfarm Wisconsin income before net operating loss carryforward	\$ 60,000
Wisconsin net operating loss carryforward from 1985 (includes farm losses from 1985)	\$(300,000)

Is an add modification required for Wisconsin tax purposes for the amount of farm losses included in the net operating loss carryforward that will be used in 1986?

Answer 9: No. Section 71.05(1)(a)26, 1985 Wis. Stats., first applies to losses incurred in 1986. Therefore, if a net operating loss carryforward from 1985 includes a net loss from farming, that loss can be carried forward without modification.

Facts and Question 10: A Wisconsin farmer has the following income and losses for 1986:

Nonfarm Wisconsin income before net operating loss carryforward	\$100,000
Wisconsin net operating loss carryforward from 1985	\$ (50,000)
Schedule F farm loss	\$ (40,000)

Is an add modification required for Wisconsin tax purposes?

Answer 10: No. The Wisconsin net operating loss carryforward from 1985 is considered nonfarm income; therefore, nonfarm adjusted gross income is \$50,000 (\$100,000 - \$50,000). Since non-

farm adjusted gross income is less than the \$55,000, no modification is required.

Facts and Question 11: Assume two Wisconsin farmers have the following income and losses for 1986:

	Farmer 1	Farmer 2
Nonfarm Wisconsin adjusted gross income	\$ 60,000	\$ 60,000
Farm #1-S Corporation (not including gain or loss below)	\$(500,000)	\$(500,000)
Farm #2-Schedule F, net farm profit	\$ 200,000	\$ 200,000
Farm #3-Partnership	\$ (35,000)	\$ (35,000)
Section 1231 loss-Farm #1 equip.	\$ (10,000)	
Section 1231 gain-Farm #1 equip.		\$ 10,000

How is the add modification under s. 71.05(1)(a)26, 1985 Wis. Stats., computed?

Answer 11: The s. 71.05(1)(a)26, 1985 Wis. Stats., add modification is calculated as follows:

	Farmer 1	Farmer 2
Farm #1 loss	\$(500,000)	\$(500,000)
Farm #3 loss	(35,000)	(35,000)
Combined net losses from a farm business	<u>\$(535,000)</u>	<u>\$(535,000)</u>
Amount allowed under s. 71.05(1)(a)26, 1985 Wis. Stats.	20,000	20,000
Add modification	<u>\$(515,000)</u>	<u>\$(515,000)</u>

Section 71.05(1)(a)26, 1985 Wis. Stats., specifies that losses allowable under sections 1211 (capital losses) and section 1231 (loss on the sale or other disposition of property used in a trade or business) of the Internal Revenue Code are not considered in calculating the add modification. Therefore, Farmer 1 does not have to limit the section 1231 loss on the sale of farm equipment.

Section 71.05(1)(a)26, 1985 Wis. Stats., also specifies that combined net losses "exclusive of net gains" are used in calculating the add modification. Therefore, Farmer 2 may not offset the losses from Farm #1 and Farm #3 by the section 1231 gain on the sale of farm equipment.

Facts and Question 12: A Wisconsin farmer has the following income and losses for 1986:

Nonfarm Wisconsin adjusted gross income	\$ 60,000
Farm #1-S Corporation	\$(500,000)
Farm #2-Schedule F, net farm profit	\$ 200,000
Farm #3-Partnership (not including gain below)	\$ (35,000)
Farm #3-Ordinary income (recapture)	\$ 10,000
Farm #3-Long-term section 1231 gain	\$ 200,000

How is the add modification under s. 71.05(1)(a)26, 1985 Wis. Stats., computed?

Answer 12: The s. 71.05(1)(a)26, 1985 Wis. Stats., add modification is calculated as follows:

Farm #1 loss	\$(500,000)
Farm #3 loss	(35,000)
Combined net losses from a farm business	<u>\$(535,000)</u>
Amount allowed under s. 71.05(1)(a)26, 1985 Wis. Stats.	20,000
Add modification	<u>\$(515,000)</u>

Under s. 71.05(1)(a)26, 1985 Wis. Stats., all section 1231 gain, including any ordinary income portion, is excluded from the computation of combined net losses from farming.

Facts and Question 13: A Wisconsin farmer reports the following transactions on federal Schedule D:

Section 1231 long-term capital gain from sale of farm asset	\$10,000
Long-term capital loss from sale of nonfarm asset	<u>(6,000)</u>
Net long-term capital gain	\$ 4,000
60% exclusion	<u>(2,400)</u>
Amount of long-term capital gain included in Wisconsin adjusted gross income	<u>\$ 1,600</u>

What amount is used in computing nonfarm Wisconsin adjusted gross income under s. 71.05(1)(a)26, 1985 Wis. Stats.?

Answer 13: The gain from selling the farm asset is considered farm income. To compute nonfarm income, another federal Schedule D must be prepared excluding the gain from selling the farm asset.

Long-term capital loss from sale of nonfarm asset	\$(6,000)
50% limitation	50%
Net long-term capital loss to be used in computing nonfarm Wisconsin adjusted gross income	<u>\$(3,000)</u>

Facts and Question 14: A Wisconsin farmer owns two farms which she rents to another farmer. The owner of the farmland participates in the operation of Farm #1, but does not participate in the operation of Farm #2. Is the rental income or loss from Farm #1 and Farm #2 farm or nonfarm income or loss for purposes of computing the Wisconsin add modification under s. 71.05(1)(a)26, 1985 Wis. Stats.?

Answer 14: The rental income or loss from Farm #1 is farm income or loss. The rental loss from Farm #2 is nonfarm loss because the farmer did not participate in the operation of the farm. The rental loss from Farm #2 will reduce nonfarm income. However, rental income from Farm #2 is neither farm income nor nonfarm income and will not reduce the farm loss nor increase nonfarm income.

Facts and Question 15: A Wisconsin farmer rents his or her farm machinery and equipment to another farmer. Is the rental income or loss farm or nonfarm income or loss for purposes of computing the Wisconsin add modification under s. 71.05(1)(a) 26, 1985 Wis. Stats.?

Answer 15: The rental loss from the rental of farm machinery and equipment is nonfarm loss and will reduce nonfarm income for purposes of computing the Wisconsin add modification under s. 71.05(1)(a)26, 1985 Wis. Stats. The rental income is neither farm

income nor nonfarm income and will not reduce the farm loss nor increase nonfarm income.

Facts and Question 16: A Wisconsin farmer does custom work for another farmer (plowing fields, thrashing grain, etc.). Is the income or loss from the custom work farm or nonfarm income or loss for purposes of computing the Wisconsin add modification under s. 71.05(1)(a)26, 1985 Wis. Stats.?

Answer 16: The income or loss from doing custom work by a farmer is farm income or loss.

Facts and Question 17: How are the dollar limits specified in s. 71.05(1)(a)26, 1985 Wis. Stats., applied for married persons filing separately?

Answer 17: The dollar limits which apply to married persons filing separately are one-half of the limits which apply to married persons filing jointly.

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2. Married Couple Credit-Computing Earned Income

Statutes: Sections 71.05(1)(a)26, 71.07 and 71.09(7m), 1985 Wis. Stats.

Background: Section 71.09(7m), 1985 Wis. Stats., provides a credit of 2.5% of the earned income of the spouse with the lower earned income not to exceed \$450. For purposes of this credit, earned income means wages, salaries, tips, other employee compensation and net earnings from self-employment allocable to Wisconsin under s. 71.07, 1985 Wis. Stats.

Question 1: An Indian living and working on her tribal reservation in Wisconsin receives wages of \$10,000 which is not taxable for Wisconsin income tax purposes. Are the wages considered earned income for purposes of the married person's credit?

Answer 1: Yes. Under s. 71.07, 1985 Wis. Stats., the wages are allocable to Wisconsin even though such income is not taxable because of overriding federal treaties and statutes.

Question 2: A taxpayer has wages of \$45,000 and a net farm loss of \$48,000 in 1986. His spouse has wages of \$20,000. For Wisconsin income tax purposes the taxpayer's farm loss is limited under s. 71.05(1)(a)26, 1985 Wis. Stats., to \$20,000 because joint nonfarm income of the taxpayer and spouse (\$45,000 + \$20,000) is greater than \$55,000. What is the taxpayer's earned income for purposes of the married person's credit?

Answer 2: Earned income includes the net earnings from self-employment. Therefore, the taxpayer must use the net loss from self-employment in computing earned income. The net loss from self-employment for Wisconsin is the federal farm loss (\$48,000) adjusted for the add modification of \$28,000 required for Wisconsin tax purposes, or \$20,000. Therefore, earned income of the taxpayer would be \$25,000 (\$45,000 - \$20,000). Because the taxpayer's spouse has the lower earned income (\$20,000), that amount is used in computing the Wisconsin married person's credit.

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3. Tier 1 Railroad Retirement Benefits

Statutes: Section 71.05(1)(b)4, 1985 Wis. Stats.

Note: This Tax Release applies only to the 1986 taxable year and thereafter.

Background: Title 45 USC 231m of the United States Code bars state and local taxation of railroad retirement benefits. However, railroad retirement benefits may be taxable for federal income tax purposes.

Section 71.05(1)(b)4, 1985 Wis. Stats., provides a subtraction modification which may remove any railroad retirement benefits included in federal adjusted gross income, when computing Wisconsin taxable income. Social security benefits are taxable for Wisconsin income tax purposes. Also, tier 1 railroad retirement benefits are combined with social security benefits to determine any taxable amount for federal purposes.

Question: Since the amount of taxable social security and railroad retirement benefits included in federal adjusted gross income is determined on the basis of the aggregate benefits received from both sources, how should the amount of railroad retirement benefits included in federal adjusted gross income be determined for purposes of the Wisconsin subtraction modification?

Answer: The following formula should be used to determine what portion of combined social security and railroad retirement benefits included in federal adjusted gross income is attributable to only railroad retirement benefits:

Amount of railroad retirement benefits included on line 21a, 1986 Form 1040	x	Amount from line 21b, 1986 Form 1040	=	Amount of railroad retirement benefits that may be claimed as a subtraction modification on line 4 Wisconsin 1986 Form 1
Total amount entered on line 21a, 1986 Form 1040				

Example: A single taxpayer has the following income in 1986:

Interest	\$21,000
Dividends	4,000
Social Security (Form SSA-1099)	5,000
Railroad Retirement (Form RRB-1099)	10,000
Total	\$40,000

The taxpayer computes the taxable amount of combined social security and railroad retirement benefits to be \$3,750 and reports it on line 21b of federal 1986 Form 1040. The taxpayer may claim a subtraction modification on line 4 of 1986 Wisconsin Form 1 of \$2,500, computed as follows using the above equation:

$$\frac{\$10,000}{\$15,000} \times \$3,750 = \$2,500$$

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CORPORATION FRANCHISE/INCOME TAXES

1. "No Tax Change" Field Audits

Statutes: Sections 71.09(13)(a), 71.10(10), 71.11(20) and (21)(a), 71.12 and 77.59(8m), 1985 Wis. Stats.

Note: This Tax Release supersedes the Tax Release titled "No Tax Change" Field Audits" which appeared in WTB 42. Changes have been made to the Background and to Answer 12 of the prior Tax Release.

Background: The Wisconsin Board of Tax Appeals held in the case of *Superior Water, Light and Power Company* (1 WBTA 274) that a "no tax letter" is not considered an additional assessment under Chapter 71 of the Wisconsin Statutes. It also indicated in its *Amber, Inc.* (2 WBTA 571) decision that an adjustment to a net business loss is not an additional assessment in the year of the net business loss. As a result of these cases, a field audit (s. 71.11(20), Wis. Stats.) does not finalize the tax or income shown on the return or audit report if a "no change" letter is issued or if business losses are adjusted but no additional tax is assessed. Such years do not become final and conclusive as a result of a field audit. Rather, these years may be later adjusted by the taxpayer or the department within the statute of limitations, or a refund may be claimed for such "no change" years as long as it also is within the statute of limitations. A net business loss, for carryover purposes, may be adjusted for years beyond the statute of limitations as long as the income year against which it is used is open to adjustment.

However, for sales tax purposes, the Wisconsin Supreme Court held in the case of *Moebius Printing Company* (89 Wis 2d 610 (1979)) that a "no change" letter issued by the department constituted a field audit per s. 77.59(2), Wis. Stats. While the no change letter did not meet all the statutory requirements (s. 77.59(3)) of a "notice of determination," it was deemed such a notice because it was "in substantial compliance" with the statute.

Net Business Loss Offsets

Question 1: Is a notice sent to a taxpayer pursuant to a field audit indicating "no tax change" in one year and an adjustment to the net business loss of another year considered an additional assessment or correction of assessment per s. 71.11(21)(a), Wis. Stats., for either of those years?

Answer 1: No. A "no tax letter" is not considered an additional assessment (*Superior Water, Light and Power Company*) and an adjustment to a net business loss is not an additional assessment in the year of the net business loss (*Amber, Inc.*).

Question 2: Are the "no tax change" for one year and the adjustment to the net business loss of another year appealable under s. 71.12 or any other statute?

Answer 2: No. A taxpayer may not seek the appeal remedies specified in s. 71.12, Wis. Stats., because the relief provided therein is available only to those who are aggrieved by an assessment, refund, or notice of denial of refund. Such would not be the case here (this was cited by the Wisconsin Board of Tax Appeals in the *Superior Water, Light and Power Company* case).