

ration may carry forward the credits from 1980 through 1986 and claim them on its 1987 corporation franchise or income tax return.

Example L: A tax-option (S) corporation had income for 1986 which it passed through to the shareholders. The manufacturer's sales tax credit available for 1986 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 1987 taxable year, the corporation may carry forward the unused portion of the 1986 credit and claim it on the corporation's 1987 franchise or income tax return.

Example M: 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.

III. Computation of Credit Carryforwards From Taxable Years That Were Closed at the Time the *Gordon* Decision Was Issued (This section explains the treatment of credits computed for taxable years that were closed by the statute of limitations prior to October 22, 1985. It does not extend the statute of limitations for any closed years.)

Facts and Question 8: A manufacturer's sales tax credit computed in 1980 which could have been used in that year was not claimed because of the department's instructions that this credit did not pass through from the tax-option (S) corporation to its shareholders. At the time that the *Gordon* decision was issued, the year was closed to adjustments. May this unused credit be carried forward to 1981 and subsequent taxable years?

Answer 8: Yes. A credit computed in 1980 which could have been used in that year but which was not claimed may be carried forward to 1981 and subsequent taxable years. However, if the tax-option (S) corporation had claimed a deduction for sales and use taxes paid on fuel and electricity used in manufacturing in computing its net income or net loss for 1980, the amount of manufacturer's sales tax credit carried forward must be reduced by the tax benefit received by the shareholders from claiming the sales tax deduction.

Example N: A shareholder's share of tax-option (S) corporation net income for 1980 was \$20,500. The corporation did not claim a deduction for sales and use taxes paid on fuel and electricity used in manufacturing. Her personal income tax measured by tax-option (S) corporation net income was \$1,400. Her share of the corporation's manufacturer's sales tax credit computed in 1980 was \$2,500. She followed the department's instructions and did not claim any portion of this credit on her 1980 individual income tax return. The shareholder may carry forward to 1981 and subsequent years the entire \$2,500 credit because no part of the credit was used in 1980 and she did not receive a tax benefit for a sales and use tax deduction.

Example O: A shareholder's share of tax-option (S) corporation net income for 1980 was \$20,000. In computing its net income, the corporation deducted \$500 of sales and use taxes paid on fuel and electricity used in manufacturing. His share of the corporation's manufacturer's sales tax credit computed in 1980 was \$500. He did not claim any portion of this credit on his 1980 individual income tax return. His net tax liability for 1980 was \$2,038. If the corporation had not deducted sales and use taxes paid on fuel and electricity in computing its net income, his net income would have increased by \$500 and his net tax liability would have been \$2,085. Thus, he received a tax benefit of \$47 (\$2,085 - \$2,038) for the sales and use tax deduction. The shareholder may carry forward to 1981 and subsequent years a manufacturer's sales tax credit of \$453 (\$500 credit - \$47 tax benefit for sales and use tax deduction).

Facts and Question 9: In 1980, a tax-option (S) corporation computed a net loss, which included a deduction for sales and use taxes paid on fuel and electricity in lieu of a manufacturer's sales tax credit. When the *Gordon* decision was issued, 1980 was closed to adjustments. In addition, no part of a manufacturer's sales tax credit computed for 1980 could have been claimed in that year since the corporation had incurred a net loss. May the corporation carry forward to 1981 and subsequent taxable years its unused manufacturer's sales tax credit computed for 1980?

Answer 9: The unused credit computed for 1980 may be carried forward to 1981 and subsequent years, but it must be reduced by the tax benefit received by the shareholders from claiming the sales and use tax deduction.

Example P: A shareholder's share of tax-option (S) corporation net loss for 1980 was \$5,000, which included a \$500 deduction for sales and use taxes paid on fuel and electricity used in manufacturing. His share of the manufacturer's sales tax credit computed for 1980 was \$500. He did not claim any portion of this credit on his 1980 individual income tax return. His net tax liability for 1980 was \$15. If the corporation's net loss had not included a deduction for sales taxes paid on fuel and electricity, his net tax liability would have been \$32. Thus, he received a tax benefit of \$17 (\$32 - \$15). The shareholder may carry forward to 1981 and subsequent years a manufacturer's sales tax credit of \$483 (\$500 credit - \$17 tax benefit for sales and use tax deduction).

Example Q: A shareholder's share of tax-option (S) corporation net loss for 1980 was \$5,000, which included a \$500 deduction for sales and use taxes paid on fuel and electricity used in manufacturing. His share of the corporation's manufacturer's sales tax credit computed for 1980 was \$500. He did not claim any portion of this credit on his 1980 individual income tax return. He had no other income or loss for 1980; therefore, he carried the \$5,000 loss over to 1981. On his 1981 return, he computed a net tax liability of \$664. If the corporation's net loss for 1980 had not included a deduction for sales and use taxes paid on fuel and electricity, his share of the corporation's net loss would have been only \$4,500 and his net tax liability for 1981 would have been \$708. Thus, he received a tax benefit of \$44 (\$708 - \$664) for the sales and use

tax deduction. The shareholder may carry forward to 1981 and subsequent years a manufacturer's sales tax credit of \$456 (\$500 credit - \$44 tax benefit for sales and use tax deduction).

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3. Taxation of Wages Earned by Indians Living on a Reservation

Statutes: Section 71.02, Wis. Stats. (1987-88)

Background: Wages earned by Indians who live and work on their own tribal reservations are exempt from Wisconsin income tax. "Indians" means all persons of Indian descent who are enrolled members of any federally recognized tribe.

Facts and Question: An Indian lives on the reservation of a federally recognized Indian tribe of which he is an enrolled member. The Indian is required by his employer to work three days a week on different reservations. Each week he works one day on his own tribal reservation and two days on reservations of tribes of which he is not an enrolled member. For the remaining two days a week he works at a office which is not located on any reservation.

Are the wages earned by this Indian exempt from Wisconsin income tax?

Answer: The exemption for an Indian living on the reservation is limited to the amount earned on the reservation of the federally recognized Indian tribe of which he or she is an enrolled member. In this case the Indian earns 20% of his wages on his tribal reservation. Therefore, 20% of his wages are exempt from Wisconsin income tax.

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FARMLAND PRESERVATION CREDIT

1. Tax Payment Requirement for "Prior Law" Filers

Statutes: Sections 71.59(1)(b) and 71.60(1)(b), Wis. Stats. (1987-88)

Background: Section 71.59(1)(b) of the Wisconsin Statutes was amended in 1988 to require that a farmland preservation credit claimant's property taxes for the preceding year on the property for which the claim is made must be paid in order to qualify for the credit. This eligibility requirement became effective with claims filed for taxable year 1988. Section 71.60(1)(b), Wis. Stats. (1987-88), provides that the credit may be calculated under the farmland preservation credit law either as it exists at the end of the year for which the claim is filed or as it existed on the date the farmland

became subject to a farmland preservation agreement or transition area agreement.

Facts and Question: John Farmer, a calendar year taxpayer, has a farmland preservation agreement executed in December 1986. He wishes to file a 1988 Wisconsin farmland preservation credit claim. However, he has not paid the 1987 property taxes for the farmland on which the claim is to be based. Is Mr. Farmer precluded from filing a claim because of sec. 71.59(1)(b), Wis. Stats. (1987-88), as long as the 1987 property taxes remain unpaid?

Answer: No. Section 71.60(1)(b), Wis. Stat. (1987-88), provides in part:

The credit for any claimant shall be the greater of either the credit as calculated under this subchapter as it exists at the end of the year for which the claim is filed or as it existed on the date on which the farmland became subject to a current agreement under subch. II or III of ch. 91, using for such calculations household income and property taxes accrued of the year for which the claim is filed.

"This subchapter" refers to subch. IX of ch. 71, which is the farmland preservation credit law. Subchapter II of ch. 91 provides for farmland preservation agreements and transition area agreements.

The taxpayer may compute a farmland preservation credit based on the law either as it existed at the end of 1988 or as it existed in December 1986. Since the taxes are not paid, he is ineligible under 1988 law, but he may compute a credit based on 1986 law, including eligibility requirements, household income, property taxes accrued, and credit computation. Since the payment of the prior year's taxes was not a requirement under 1986 law, Mr. Farmer's nonpayment of his 1987 property taxes does not preclude him from filing a claim using the law for 1986.

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CORPORATION FRANCHISE OR INCOME TAXES

1. Sales Factor—Throw Back of Sales From States in Which a Combined or Consolidated Return Is Filed

Statutes: Sections 71.25(9) and 71.26(3)(x), Wis. Stats. (1987-88)

Wis. Admin. Code: Section Tax 2.39, January 1978 Register

Background: Section 71.25(9), Wis. Stats. (1987-88), provides that the numerator of the Wisconsin sales factor includes 50% of the sales of tangible personal property shipped from a location in Wisconsin to a location in a state in which the taxpayer is not within the jurisdiction of the destination state for income tax purposes.

In Wisconsin, each corporate entity is required to file a separate Wisconsin return and compute its Wisconsin net income on a separate entity basis. Combined or consolidated returns are not allowed. Certain other states may require or allow the filing of combined or consolidated returns.

Question: Are sales of tangible personal property, shipped by a taxpayer to a state in which the taxpayer's net income is included in a combined return of a unitary group of corporations filed with the destination state, required to be included in the numerator (thrown back to Wisconsin) when computing the Wisconsin sales factor?

Answer: If the activities of the taxpayer, on a separate entity basis, in the destination state do not subject the taxpayer to the jurisdiction of that state for income tax purposes, the sales should be thrown back (at 50%) to Wisconsin. If the activities of the taxpayer, on a separate entity basis, in the destination state are sufficient to subject the taxpayer to the jurisdiction of that state for income tax purposes, the sales should not be thrown back to Wisconsin.

Example: Corporation A, headquartered in Minnesota, is the parent of a unitary group of corporations. Subsidiary B, headquartered in Illinois, files an Illinois return and reports the net income of the entire group on a combined basis. Subsidiary C, headquartered in Wisconsin, makes some sales into Illinois and its income is included in the combined return filed in Illinois by Subsidiary B. Subsidiary C has no activity in Illinois other than the sales shipped from Wisconsin and is not subject to the jurisdiction of Illinois for income tax purposes. Therefore, the sales made by Subsidiary C into Illinois should be thrown back to Wisconsin for purposes of the Wisconsin sales factor of Subsidiary C.

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SALES/USE TAXES

1. Appraisals of Tangible Personal Property

Statutes: Section 77.52(2)(a), Wis. Stats. (1987-88)

Question: Company ABC is in the business of appraising jewelry, coins, furniture, etc. For performing the appraisal, Company ABC charges a fee. Is the fee subject to Wisconsin sales tax?

Answer: No. Section 77.52(2), Wis. Stats. (1987-88), imposes a sales tax on the gross receipts from the sale, performance or furnishing of certain services. Of the services listed in sec. 77.52(2)(a)1 through 20, Wis. Stats. (1987-88), appraising is not included. Therefore, the appraisal fees are not subject to Wisconsin sales tax.

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2. Is Refurbishing or Remaking Railroad Cars and Freight Car Wheels Manufacturing?

Statutes: Section 77.54(6)(a) and (6m), Wis. Stats. (1987-88)

Wis. Adm. Code: Sections Tax 11.38, October 1976 Register, Tax 11.39 and 11.41, July 1987 Register, and Tax 11.40, November 1981 Register.

Facts and Question: Company XYZ (XYZ) operates a complete rail car repair center in Wisconsin. The facility is set up into functional areas, a freight car repair facility ("rip track"), a wheel shop where railroad wheel sets are retooled and rebuilt, and a passenger car refurbishing area.

The freight car "rip track" is where damaged freight cars are repaired. The repair facility is clearly not manufacturing, and is not at issue here.

In the "wheel shop" area, freight car wheel sets are retooled and rebuilt to specifications on an assembly line as follows:

- a. Wheel sets are transported to XYZ by semi-trailer and unloaded at the plant sight.
- b. The wheel sets are inspected to determine if any parts are salvageable.
- c. The wheel sets are dismantled and reusable parts are retained.
- d. The reusable parts are remanufactured and added with new parts to form new wheel sets which are placed into finished goods inventory.
- e. The wheel parts are sold outright to rail car manufacturers, exchanged for scrap wheel sets, or sold to various railroads and rail car leasing companies.

As another part of XYZ's business, passenger rail cars are refurbished to customer specifications and by specific customer order at XYZ's main plant.

The scrap railroad car is towed to XYZ on rail lines or on flatbed cars. XYZ also maintains a stock pile of scrap railroad cars for those customers that do not wish to purchase and ship their own. Approximately 70% of the railroad cars refurbished are supplied by XYZ and the cost is included in the total contract price.

Once a contract is obtained to refurbish a railroad car, the car is pulled or pushed to XYZ's facility by XYZ's own switching locomotive. Then, the car is completely stripped of any remaining plumbing, electrical, and interior systems. The exterior shell and frame are inspected and damaged, decayed, worn, or rusted materials are removed.

XYZ has the following departments in its rebuilding operation: cabinet shop, electrical, painting, plumbing, engineering, and interior design.

The railroad car is completely overhauled and operations include replacing exterior shells, constructing open end platforms, and

rebuilding entrances, exits, and interiors, all to the customer's specification. New electrical, plumbing, heating, and ventilating systems are installed.

The value of a railroad car is as low as \$10,000 before XYZ begins work and after 6 to 9 months of work, the car may be worth \$350,000 to \$600,000, depending upon the work involved.

The properties where the work on freight car wheels and railroad cars is done are currently zoned "M-1 Industrial." XYZ reports all equipment as manufacturing equipment used in the transformation of materials and components. XYZ considers itself exempt from personal property taxes.

The rebuilding of railroad cars is listed as a manufacturing activity under Section 3743 of the *Standard Industrial Classification Manual*, 1987 Edition.

- a. Does the remanufacture, to original specifications, of railroad freight car wheels constitute manufacturing for Wisconsin sales and use tax purposes?
- b. Does the refurbishing or remaking of railroad cars constitute manufacturing for Wisconsin sales and use tax purposes?

Answer:

- a. Yes. The remanufacture of railroad freight car wheels, as performed by XYZ, constitutes manufacturing under sec. 77.54(6m), Wis. Stats. (1987-88). The situation is similar to that in the case of *Argyle Industries, Inc. vs. Wisconsin Department of Revenue*, (Docket No. I-8393, July 25, 1983). The Commission concluded in that case that Argyle's "remanufacturing" of automobile parts from new and used component parts constituted manufacturing.
- b. Yes. The refurbishing or remaking of passenger railroad cars, to the degree and scale engaged in by XYZ, constitutes manufacturing under sec. 77.54(6m), Wis. Stats. (1987-88).

Note: The scope of this Tax Release only encompasses whether particular operations constitute manufacturing. The question of exclusive use of machinery and equipment in the manufacturing operations for purposes of sales and use tax exemptions is not addressed.



PRIVATE LETTER RULINGS

"Private letter rulings" are written statements issued to a taxpayer by the department that interpret Wisconsin tax laws to the taxpayer's specific set of facts. Any taxpayer may rely upon the ruling to the same extent as the requestor, provided the facts are the same as those set forth in the ruling.

The number assigned to each ruling is interpreted as follows: The first two digits are the year issued, the next two digits are the week issued, and the last three digits are the number in the series of rulings issued that year. "Issued" means when the ruling is available to be published (80 days after being mailed to the requester). The date following the 7-digit number is the date the ruling was mailed to the requester.

Certain information contained in the ruling that could identify the taxpayer requesting the ruling has been deleted. Wisconsin Publication 111, "How to Get a Private Letter Ruling From the Department of Revenue," contains additional information about private letter rulings.

W 8927002, April 19, 1989

Type Tax: Sales/Use

Issue: Manufacturing Machinery and Equipment; Property Consumed in the Manufacturing Process

Statutes: Sections 77.54(2) and (6)(a), Wis. Stats. (1987-88)

This letter responds to your request for a private letter ruling regarding the classification of the production of microfiche as manufacturing for purposes of the sales tax exemption for machinery and equipment, s. 77.54(6)(a), and property consumed in manufacturing, sec. 77.54(2), Wis. Stats.

Facts: A operates a micrographics service business. The company receives computer tapes and cassettes in various electronic data formats from clients. This machine readable information is reprogrammed to satisfy client output format requirements. Microfiche copies of the data are produced, without conversion of the data through a paper report state.

In this process, A consumes supplies in the production of microfiche for clients including computer tapes, photographic sensitive film, processing chemicals, and paper packaging materials.

You have indicated that A has purchased equipment from DatagraphiX, Inc. of San Diego, California, and is financing the purchase through B a division of A. The cost of the equipment was \$164,000 and the monthly financing lease payments are \$5,326. Use tax was not paid on the acquisition from DatagraphiX nor on the lease payments, as A believes this equipment is being used exclusively in a manufacturing process.

A also purchases supplies which are consumed exclusively in the production of microfiche. A sells the reformatted information by transfer of the completed microfiche product.

You describe the process as involving the conversion of machine readable electronic data into a human readable format and you further describe the process as set forth below.