

TAX RELEASES

("Tax Releases" are designed to provide answers to the specific tax questions covered, based on the facts indicated. In situations where the facts vary from those given herein, the answers may not apply. 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

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INDIVIDUAL INCOME TAXES

1. Taxability of Interest From Proprietary Zero-Coupon Certificates

Statutes: Section 71.05(6)(b)1, Wis. Stats. (1987-88)

Background: Various brokerage firms market a type of security called "proprietary zero-coupon certificates," which are certificates of ownership of U.S. Treasury obligation cash flows. These proprietary certificates are marketed under various brand names (for examples, see Answer 2 below). Proprietary zero-coupon certificates differ from physical U.S. Treasury zero-coupon obligations in that in proprietary zero-coupon certificates, a U.S. Treasury note or bond is purchased by a brokerage firm, which then "strips" the note or bond and issues certificates against the coupon and principal cash flows. The investor purchases the right to receive an interest or principal payment from the Treasury issue. The investor does not purchase the actual Treasury obligation.

Question 1: Is interest from proprietary zero-coupon certificates taxable by Wisconsin?

Answer 1: No. The interest received through proprietary zero-coupon certificates attributable to interest from federal obligations is exempt from Wisconsin taxation under sec. 71.05(6)(b)1, Wis. Stats. (1987-88). That section provides that the amount of any

interest which by federal law is exempt from state taxation may be subtracted from adjusted gross income to the extent included in federal taxable income. Under 31 U.S.C. § 3124(a), stocks and obligations of the U.S. Government are exempt from taxation by a state. The tax-exempt status of interest from U.S. Government obligations flows through the proprietary zero-coupon certificate.

Question 2: What are some examples of "brand names" under which brokerage firms market proprietary zero-coupon certificates?

Answer 2: Treasury obligation based proprietary zero-coupon products are known by such brand names and acronyms as CATs, TIGRs, Cougars, ETRs, LIONs, STARs, ZEBRAs, etc.

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2. Taxation of Compensation for Well Contamination

Statutes: Sections 71.03(2)(g), Wis. Stats. (1983-84) and 71.01(6), Wis. Stats. (1987-88)

Background: Under sec. 144.027, Wis. Stats. (1987-88), the Department of Natural Resources may award to any claimant 80% of eligible costs not to exceed \$12,000 to replace a contaminated well or contaminated private water supply.

Question 1: Are payments received under sec. 144.027, Wis. Stats. (1987-88), taxable for federal income tax purposes?

Answer 1: Yes. Federal law provides that all income is taxable unless a specific exemption applies. Because no exemption applies to these payments, the payments must be included in federal adjusted gross income.

Note: The payments under sec. 144.027, Wis. Stats. (1987-88), should not be confused with Private Sewage System Replacement or Rehabilitation Program payments which are issued under sec. 144.245, Wis. Stats. (1987), and which may be exempt from federal taxation under sec. 126 of the Internal Revenue Code.

Question 2: Are payments received under sec. 144.027, Wis. Stats. (1987-88), taxable for Wisconsin income tax purposes?

Answer 2: For 1985 and prior taxable years, sec. 71.03(2)(g), Wis. Stats. (1983-84), provided that all amounts received in accordance with sec. 144.027 were exempt from Wisconsin taxation. For taxable years 1986 and thereafter, this exemption was repealed. Therefore, because such payments are included in federal adjusted gross income, the starting point for determining Wisconsin taxable income, and no exemption or modification exists with regard to these payments, they are taxable for Wisconsin income tax purposes for taxable years 1986 and thereafter.

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3. Treatment of Incentive Stock Options for Alternative Minimum Tax Purposes

Statutes: Section 71.08(1)(bm), Wis. Stats., as created by 1989 Wisconsin Act 31

Note: This Tax Release applies only with respect to taxable years beginning on or after January 1, 1989.

Background: Under sec. 71.08, Wis. Stats. (1987-88), a taxpayer is liable for Wisconsin alternative minimum tax if the taxpayer's minimum tax is greater than the taxpayer's regular income tax. The amount of Wisconsin alternative minimum taxable income is computed by starting with the taxpayer's federal alternative minimum taxable income and making certain Wisconsin modifications to that amount.

In computing federal alternative minimum taxable income, a taxpayer is required to add to taxable income any income excluded under sec. 421, IRC, with regard to the transfer of stock acquired pursuant to the exercise of an incentive stock option. In the year of disposition of stock, federal alternative minimum taxable income is reduced to account for the difference in basis of the stock as a result of the adjustment made to federal alternative minimum taxable income in the year of exercise.

Section 71.08(1)(bm), Wis. Stats. as created by 1989 Wisconsin Act 31, provides that for stock acquired after December 31, 1987, there may be subtracted from federal alternative minimum taxable income 20% of the amount included in federal alternative minimum taxable income as an incentive stock option adjustment (referred to as subd. 1). If the provisions of subd. 1. apply, a 20% reduction must also be made to any basis adjustment required for federal alternative minimum tax purposes in the year of disposition of the stock (referred to as subd. 2.). These provisions are effective for taxable years beginning on or after January 1, 1989.

Section 71.08(4), Wis. Stats. (1987-88), provides that federal alternative minimum taxable income may be reduced for purposes of computing Wisconsin alternative minimum taxable income to prevent the inclusion of any amounts, with certain exceptions, that do not reflect a benefit in respect to the tax imposed under sec. 71.02 (imposition of Wisconsin regular income tax).

Facts and Question 1: Taxpayer A, a resident of Wisconsin, exercised an incentive stock option in taxable year 1988. Taxpayer A included the necessary adjustment as a result of exercising the incentive stock option in 1988 federal alternative minimum taxable income. As a result of including the necessary adjustment in federal alternative minimum taxable income, the adjustment was also included in Wisconsin alternative minimum taxable income.

In 1989, Taxpayer A disposes of the stock and makes the required basis adjustment which decreases his 1989 federal alternative minimum taxable income.

Is Taxpayer A required to reduce the basis adjustment included in 1989 federal alternative minimum taxable income by 20% when computing 1989 Wisconsin alternative minimum taxable income?

Answer 1: No. Taxpayer A was not allowed to take the 20% reduction under subd. 1. in computing 1988 Wisconsin alternative minimum taxable income because that provision was not yet effective. Subd. 2. applies only if the stock was subject to subd. 1. Because the stock disposed of in 1989 was not subject to the provisions of subd. 1., subd. 2. does not apply.

Facts and Question 2: Taxpayer B was a nonresident of Wisconsin in 1989. In 1989, Taxpayer B exercised an incentive stock option and included in 1989 federal alternative minimum taxable income the adjustment required as a result of the exercise. Taxpayer B was not required to file a 1989 Wisconsin income tax return.

In 1990, Taxpayer B becomes a Wisconsin resident and disposes of the stock acquired pursuant to the exercise of the incentive stock option. Taxpayer B makes the required basis adjustment when computing her 1990 federal alternative minimum taxable income.

Is Taxpayer B required to reduce the basis adjustment included in 1990 federal alternative minimum taxable income by 20% when computing 1990 Wisconsin alternative minimum taxable income?

Answer 2: No. Because Taxpayer B was not subject to Wisconsin taxation in 1989, the provisions of subd. 1. did not apply. Because the stock disposed of in 1990 was not subject to the provisions of subd 1., subd. 2. does not apply.

Facts and Question 3: Taxpayer C was a nonresident of Wisconsin in 1989. However, Taxpayer C was required to file a Wisconsin income tax return. In computing 1989 Wisconsin alternative minimum taxable income, Taxpayer B subtracted from federal alternative minimum taxable income 100% of the adjustment required pursuant to the exercise of an incentive stock option. The subtraction was made under sec. 71.08(4), Wis. Stats. (1987-88). Taxpayer C did not receive a benefit for Wisconsin from the exclusion of income pursuant to the exercise of an incentive stock option because such income is intangible income which follows the residence of the taxpayer and is not taxable by Wisconsin with regard to a nonresident.

In 1990, Taxpayer C becomes a resident of Wisconsin and disposes of the stock acquired pursuant to the exercise of the incentive stock option. Taxpayer C makes the required basis adjustment when computing his 1990 federal alternative minimum taxable income.

Is Taxpayer C required to reduce the basis adjustment included in 1990 federal alternative minimum taxable income by 20% when computing 1990 Wisconsin alternative minimum taxable income?

Answer 3: No. Taxpayer C excluded from 1989 Wisconsin alternative minimum taxable income 100% of the incentive stock option adjustment, using the provisions of sec. 71.08(4), Wis. Stats. (1987-88). Therefore, subd. 1. did not apply. Because the stock disposed

of in 1990 was not subject to the provisions of subd. 1., subd. 2. does not apply.

Facts and Question 4: In 1989, Taxpayer D, a resident of Wisconsin, exercised an incentive stock option and included in federal alternative minimum taxable income the required adjustment as a result of the exercise of the incentive stock option. The adjustment was also included in Wisconsin alternative minimum taxable income but was reduced by 20% as provided by subd. 1. However, even if Taxpayer D had not made the 20% reduction, she would not have owed a Wisconsin alternative minimum tax.

In 1990, Taxpayer D disposes of the stock acquired pursuant to the exercise of the incentive stock option. Taxpayer D makes the required basis adjustment when computing her 1990 federal alternative minimum taxable income.

Is Taxpayer D required to reduce the basis adjustment included in 1990 federal alternative minimum taxable income by 20% when computing her 1990 Wisconsin alternative minimum taxable income?

Answer 4: No. Taxpayer D received no tax benefit from subd. 1. in the year of exercise. Since Taxpayer D did not receive any tax benefit from the 20% deduction under subd. 1., the 20% addition under subd. 2. does not apply when the stock is sold. Note that if Taxpayer D had received a partial tax benefit from subd. 1. in the year of exercise, subd. 2 would apply proportionately in the year of disposition of the stock.

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SALES/USE TAXES

1. Meals and Lodging Provided by Nursing Homes

Statutes: Sections 77.52(2)(a)1 and 77.54(20)(c)4, Wis. Stats. (1987-88)

Wis. Adm. Code: Section Tax 11.87, September 1984 Register

Facts and Question: The January 29, 1982, Wisconsin Tax Appeals Commission decision in *Rause Enterprises, et. al.*, held that a fast food restaurant operator can purchase disposable plastic eating utensils, napkins, straws, and disposable place mats without tax for resale.

May a nursing home operator (that is not exempt as a nonprofit organization under sec. 77.54(9a)(f), Wis. Stats. (1987-88)) purchase these same items without tax for resale?

Answer: Yes. A nursing home may issue a resale certificate to its supplier(s) for purchases of paper and plastic disposable items which are transferred to customers (including residents and visi-

tors) in conjunction with providing meals, food, food products, and beverages to its customers.

Nursing homes are retailers of the following three items: lodging, meals, and health care services. Sales of lodging are not taxable under sec. 77.52(2)(a)1, Wis. Stats. (1987-88); sales of meals are exempt under sec. 77.54(20)(c)4, Wis. Stats. (1987-88); and health care services are not included in the list of taxable services in sec. 77.52(2)(a), Wis. Stats (1987-88).

Caution: This treatment only applies to restaurant or food service type items which are actually transferred to the customers in conjunction with the sale of meals, food, food products, and beverages. It does not apply to items transferred in conjunction with free meals or beverages (e.g., hotel styrofoam cups for free coffee) or for items consumed by the nursing home in providing nontaxable health care services (e.g., disposable diapers).

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2. Mechanical and Electronic Voice Messaging Services

Statutes: Secs. 77.52(2)(a)4, Wis. Stats. (1987-1988), and 77.52(2)(a)5, Wis. Stats., as created by 1989 Wis. Act. 31, effective October 1, 1989.

Wis. Adm. Code: Rule Tax 11.66, July 1987 Register

Facts and Question: An EVX Office Message System computer is located in the office of a service provider, and customers gain access to the computer by using any touch-tone telephone. The service provider describes the business as voice messaging. 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.

This voice messaging service may be used as (a) a message center, (b) a call forwarding service, or (c) 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 messages to other users, or broadcast group messages with group distribution codes.

Is this mechanical or electronic voice messaging and telephone answering service taxable as a telecommunications service under secs. 77.52(2)(a)4, Wis. Stats. (1987-1988), and 77.52(2)(a)5, Wis. Stats. as created by 1989 Wis. Act 31, effective October 1, 1989?

Answer: Yes. This mechanical or electronic voice messaging and telephone answering service is subject to sales and use tax as a telecommunication service.

Note: This tax release represents a change in department position and becomes effective May 1, 1990.

Note: Nonmechanical and nonelectronic telephone answering services continue to be nontaxable as stated in section Tax 11.66(1)(c), Wis. Adm. Code.

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ALL TAXES

1. Withholding of Delinquent State Taxes From Lottery Prizes

Statutes: Section 565.30(5), Wis. Stats. (1987-88)

Background: Section 565.30(5), Wis. Stats. (1987-88), provides that the Executive Director of the Lottery Board shall report the name, address, and social security number of each winner of a lottery prize equal to or greater than \$1,000 to the Department of Revenue to determine whether the payee of the prize is delinquent in the payment of state taxes, court ordered child support, and debts owed to other state agencies. Upon certification by the Department of Revenue or upon court order, the Executive Director shall withhold the certified amount for remittance to the appropriate agency or person.

In a Tax Release titled "Taxation of Lottery Winnings," WTB 61, page 16, it stated that a lottery prize could be shared among several people and that each person sharing in the lottery prize was considered a winner. However, for purposes of withholding Wisconsin income taxes, the \$2,000 limit under s. 71.67(4), Wis. Stats. (1987-88), applied to the total lottery prize and not each winner's share of the lottery prize.

Question 1: For purposes of sec. 565.30(5), Wis. Stats. (1987-88), does the \$1,000 limit apply to the total lottery prize or each winner's share of the lottery prize?

Answer 1: The \$1,000 limit, for purposes of determining whether a payee is delinquent in the payment of Wisconsin taxes, applies to the total lottery prize and not each winner's share of the lottery prize.

Example: Taxpayers A, B, and C agree to share any proceeds from a Wisconsin lottery ticket, prior to the determination that the ticket is a winner. The lottery prize of the ticket is \$1,500. The provisions of sec. 565.30(5), Wis. Stats. (1987-88), apply because the total prize is over \$1,000. This is true even though each winner's share of the prize (\$500) is less than \$1,000. If the payee has notified the Lottery Board that there are several person's sharing in the prize, the records for taxpayers A, B, and C will be examined to determine if they owe delinquent Wisconsin taxes.

Question 2: If a taxpayer is delinquent in payment of Wisconsin income taxes and shares equally in a lottery prize with 2 other

persons, can the entire lottery prize be certified by the Department of Revenue and applied against the taxpayer's delinquent Wisconsin income taxes?

Answer 2: No. The Department of Revenue may only certify for application against delinquent Wisconsin income taxes, the delinquent taxpayer's share of a lottery prize.

Example: Taxpayers A, B, and C agree to share any proceeds from a Wisconsin lottery ticket, prior to the determination that the ticket is a winner. The lottery prize of the ticket is \$10,000. Taxpayer A has delinquent state income taxes of \$10,000. The department may only certify \$3,333.33 of the \$10,000 lottery prize, Taxpayer A's share, for application against Taxpayer A's delinquent Wisconsin income taxes.

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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 requestor). The date following the 7-digit number is the date the ruling was mailed to the requestor.

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

W9002001, October 25, 1989

Type Tax: Sales/Use

Statutes: Sections 77.51(4)(a) and (13) and 77.52(2)(a)20, Wis. Stats. (1987-88)

Issue: Landscaping services; turf grass advisory services

This letter responds to your request for a private letter ruling regarding the sales and use tax status of turf grass advisory services provided by Company A.