carry on any substantial business activity and did nothing to earn the income they reported. The earnings were actually the result of Kohler Company's labor and employment of capital and should be taxed as such.

A DISC that meets only the minimum qualifying requirements, with no actual operations, is a "paper corporation." A corporation must meet more requirements to qualify as an FSC than as a DISC. However, the minimum qualifying requirements of an FSC generally do not give rise to substance. The actual operations, rather than the minimum qualifying requirements, of an FSC determine whether or not an FSC is a "paper corporation."

The basic structure of an Interest-Charge DISC has not changed from that of a DISC. Accordingly, an Interest-Charge DISC that meets only the minimum qualifying requirements, with no actual operations, is a "paper corporation."

Question 1: What is the Wisconsin treatment of FSCs?

Answer 1: Wisconsin Statutes provide no special tax treatment for FSCs. Section 71.26(3)(r) & (t), Wis. Stats. (1987-88), specifically excludes the federal tax treatment of FSCs. The net income of an FSC is subject to taxation as a separate corporation, if it has nexus in Wisconsin and is not a "paper corporation." If the FSC is a paper corporation, its net income is allocated to and includable in the income of the corporation that earned it. The net income to be allocated is the entire net income before the federal income and expense adjustments for foreign source income.

Example 1: FSC-A, a subsidiary of XA Corporation, is incorporated in the U.S. Virgin Islands. FSC-A pays management fees of $250,000 annually to XA Corporation for acting as its agent. In order to meet the federal qualification for having foreign presence FSC-A also pays $200 in rent to a foreign agent, who acts in that capacity for many other FSCs.

To meet the remaining federal requirements, FSC-A:

a. Sent copies of its books and invoices to an office in the U.S. Virgin Islands.

b. Maintained two U.S. Virgin Islands residents (local attorneys) on the corporation's Board of Directors.

c. Held its annual shareholder and Board of Director meetings in the U.S. Virgin Islands by proxy through one of the U.S. Virgin Islands directors.

d. Maintained a principal bank account in the U.S. Virgin Islands. However, checks are signed by one of two employes of the parent.

e. Solicited, negotiated or made all export sales contracts outside the U.S. through its contracted agent, its parent.

FSC-A employed a management company to:

a. Incorporate the FSC in the U.S. Virgin Islands.

b. Set up the FSC by performing the proper filings.

c. Supply an office to maintain the FSC's books.

d. File annual corporate reports and franchise tax reports in the U.S. Virgin Islands, as prepared by the parent.

e. Arrange for and conduct annual meetings of shareholders and Board of Directors in the U.S. Virgin Islands.

FSC-A is considered a "paper corporation." It has no employes and it has no actual involvement or activity in connection with the sales that give rise to its income. The income is the result of the labor and employment of capital of XA Corporation. Therefore, the income of FSC-A must be allocated to the corporation which actually earned the income, pursuant to sec. 71.11(7m), Wis. Stats. (1985-86), or sec. 71.30(2), Wis. Stats. (1987-88), and sec. 482, IRC. In this case, the income would be allocated to XA Corporation.

Example 2: Corporation A is a Wisconsin based manufacturer. In July 1986, Corporation A created a wholly-owned subsidiary, XYZ, Inc. XYZ, Inc. was incorporated in the U. S. Virgin Islands and elected to be treated as an FSC pursuant to the requirements of secs. 921 through 927, IRC. Corporation A transferred $1,000 to XYZ, Inc. and in return received 1,000 shares of common stock of XYZ, Inc. Corporation A began filing as a tax-option (S) corporation on September 1, 1986.

Three shareholders own the stock of Corporation A, and on August 30, 1986, the officers of Corporation A were authorized to sell the shares of XYZ, Inc. to two of the shareholders of Corporation A for the same price paid by Corporation A.

Other facts regarding XYZ, Inc. are:

1. All billing and ordering takes place in Wisconsin.

2. Books are maintained in Wisconsin and a duplicate set of books is retained in the U.S. Virgin Islands.

3. One foreign resident is on the Board of Directors.

4. All accounting and legal business takes place in Wisconsin.

5. All tax services are performed by an independent accounting firm located in Wisconsin.

6. Only $1,000 of capital is maintained by XYZ, Inc., which is insufficient to generate the reported income.

7. XYZ, Inc. owns no tangible personal property.

There is also a management agreement between a service corporation and XYZ, Inc. which required the service corporation to:

1. Act as local resident agent of XYZ, Inc., in the U.S. Virgin Islands.

2. Maintain a staffed and equipped office in the U.S. Virgin Islands.

3. Maintain a secure set of books and records for XYZ, Inc., in the U.S. Virgin Islands.

4. Provide for a resident director of XYZ, Inc.

5. Provide an additional non-U.S. resident director if requested.

For the services, an annual fee of $1,500 was charged to XYZ, Inc.

XYZ, Inc., is considered a "paper corporation," even though the minimum requirements, under the IRC, have been met. XYZ, Inc., has no employes or actual involvement or activity in connection with the sales that give rise to its income. The office in the U.S. Virgin Islands is actually that of the service corporation. Accordingly, the net income of XYZ, Inc., must be allocated to Corporation A, the company which actually earned the income.

Example 3: In March of 1985, Company A set up a subsidiary, Company B, as an FSC to take advantage of the benefits provided in the FSC provisions of the IRC. Company A owns 100% of the stock of Company B.

To meet the IRC requirements, Company B has the following presence in the U.S. Virgin Islands.

1. It was incorporated in the U.S. Virgin Islands.

2. It maintains an office in the U.S. Virgin Islands.

3. Certain records are maintained in the U.S. Virgin Islands' office, including copies of invoices, quarterly profit and loss statements, Board of Directors' minutes, foreign tax information and a copy of the Articles of Incorporation.

4. One member of the Board of Directors is a resident of the U.S. Virgin Islands. This person files the local tax information.

5. Two clerical personnel are retained to maintain the records which are sent to the office from Company A.

Items 1 through 5 are arranged for and managed by an unrelated financial service corporation. The financial service corporation receives $1,500 per year for this service. The funds for this payment come from Company A. Out of this $1,500 the service corporation pays the rent for the office space and compensates the three individuals for the services they perform.

Company B's function is to act as a wholesaler of certain types of manufacturing equipment which is manufactured by Company A. Company A performs all of the sales functions for Company B, including taking orders, filling orders, billing, and collecting. Company A also controls all of the funds. Company B has no separate bank account. The only money that flows to the U.S. Virgin Islands is the $1,500 annual payment to the service corporation, an annual franchise fee of $400 and an annual license fee of $100.

Company B is a "paper corporation." It had no actual employes and the clerical employes are actually employes of the financial service corporation. It also doesn't have any actual involvement or activity in connection with the sales that give rise to the income. The income is the result of the labor and employment of capital of Company A. Therefore, the net income of Company B must be allocated to the corporation that earned it, Company A.

Example 4: Corporation A is a Wisconsin based manufacturer that exports its products on a worldwide basis. On January 1, 1985, Corporation A created a wholly-owned subsidiary, ABC Virgin Islands, Inc. ABC Virgin Islands, Inc. was incorporated under the laws of the U.S. Virgin Islands and elected to be treated as an FSC pursuant to the IRC requirements. On January 1, 1985, Corporation A transferred $1,000 cash to ABC Virgin Islands, Inc. In exchange for the cash, Corporation A received 100 shares of common stock of ABC Virgin Islands, Inc.

The Board of Directors' minute book indicates that ABC Virgin Islands, Inc. appointed Corporation A to do the following by a supplier and agency agreement:

1) Solicitation, negotiation and contracting functions
2) Advertising and sales promotion
3) Final invoice determination and transmittal
4) Customer order processing
5) Delivery
6) Transportation
7) Receipt of payment
8) Credit risk functions

The minute book also indicates that a management agreement with a separate service corporation provided for the following:

1) Have 2 residents of the U.S. Virgin Islands to maintain residency requirements and be on the Board of Directors.
2) Maintain an office.
3) Maintain a telephone.
4) Maintain a U.S. Post Office Box.
5) Maintain duplicate records.
6) Maintain officer's liability insurance.

The management agreement also required the service corporation to:

1) Act as local resident agent of the FSC in the U.S. Virgin Islands.
2) Maintain a staffed and equipped office in the U.S. Virgin Islands.
3) Maintain a secure set of books and records for the FSC in the U.S. Virgin Islands.
4) Provide the necessary non-U.S. resident director for the U.S. Virgin Islands' FSC.
5) Arrange Board of Director and shareholder meetings in the U.S. Virgin Islands.
6) Assist in the opening and maintenance of a foreign bank account for the FSC in the U.S. Virgin Islands.
7) Provide support staff.

For the services, the FSC pays an annual fee of approximately $3,500. An agency fee of $6,000 is also paid by the FSC.

All sales are made through the parent company with commission income and commission expense being allocated between the parent and FSC, respectively. The parent prepares the necessary annual reports and franchise tax reports to be filed in the U.S. Virgin Islands. All accounting (i.e., invoicing, collecting, etc.) is handled by the parent. The FSC has no capital assets or inventory in the U.S. Virgin Islands.

ABC Virgin Islands, Inc. is considered a "paper corporation," as it only meets the minimum federal requirements and its operating functions are performed by the parent on its behalf. Its income must be allocated under sec. 71.30(2), Wis. Stats. (1987-88), (sec. 71.11(7m), Wis. Stats. (1985-86)) to Corporation A, the entity that earned it.

Example 5: FSC-B, a subsidiary of ZB Corporation, is incorporated in the U.S. Virgin Islands. It not only meets all the minimum federal requirements, it owns and uses over $300,000 of tangible property in the production of its income and has an annual payroll of approximately $2,000,000. Its annual sales exceed $30,000,000. FSC-B operates exclusively as an exporting corporation for ZB Corporation.

Based on these facts, FSC-B is not a "paper corporation" and its income is taxed by Wisconsin like any other corporation, that is, tax is imposed on FSC-B. The income subject to taxation is not reduced by the federal adjustments for income and expenses relating to foreign source income. The income is apportioned or allocated to Wisconsin pursuant to sec. 71.25, Wis. Stats. (1987-88).

Question 2: What is the Wisconsin treatment of Interest-Charge DISCs?

Answer 2: The net income of an Interest-Charge DISC is not combined with its parent or affiliate pursuant to sec. 71.11(7r), Wis. Stats. (1985-86), or sec. 71.30(5), Wis. Stats. (1987-88), since it does not have the meaning specified in sec. 992, IRC, as amended to December 31, 1979. Its net income will be subject to taxation as a separate corporation provided it is not a "paper corporation." If the DISC is determined to be a "paper corporation," its net income is allocated to the corporation that earned the income pursuant to sec. 71.11(7m), Wis. Stats. (1985-86), or sec. 71.30(2), Wis. Stats. (1987-88), and sec. 482, IRC.

Question 3: Is the interest expense paid to the federal government for an Interest-Charge DISC a deductible expense?

Answer 3: The interest expense is deductible by a corporation required, under the IRC, to make payment. There is no modification under sec. 71.26(3), Wis. Stats. (1987-88), for this interest expense.

❐

SALES/USE TAXES

1. Incidental Highway Construction Work

Statutes: Sections 77.51(14)(intro.) and (i) and 77.52(1) and (2)(a), Wis. Stats. (1987-88)

Wis. Adm. Code: Sections Tax 11.29(4)(a), July 1977 Register and Tax 11.68, April 1990 Register

Background: Section 77.51(14)(i), Wis. Stats. (1987-88), provides that "sale at retail" includes sales of building materials, supplies, and equipment to owners, contractors, subcontractors, or builders for the erection of buildings or structures or the alteration, repair, or improvement of real property. Therefore, real property construction contractors are the consumers of tangible personal property they use in altering, repairing, or improving real property and are subject to tax on such property.

Section Tax 11.68(1)(b), Wis. Adm. Code, provides that contractors are retailers of:

A. Property which retains its character as personal property after sale and installation.

B. Labor or services furnished in installing tangible personal property which retains its character as personal property after installation.

C. Labor and materials furnished in the repair, service, alteration, fitting, cleaning, painting, coating, towing, inspection, and maintenance of real property which retains its character as tangible personal property for repair purposes.

D. Tangible personal property sold.

As a retailer, the contractor is required to charge Wisconsin sales tax on sales of these items unless the items are for resale or otherwise exempt.

However, sec. Tax 11.68(5), Wis. Adm. Code, provides that a construction contractor is the consumer of personal property which becomes a part of real property.

The Wisconsin Court of Appeals, District IV, in the decision of *Tom Kuehne Landscape Contractor, Inc. v. Department of Revenue*, dated October 20, 1987, held that a contractor's installation of highway signs, sign bridges, delineator posts, and guardrails did not constitute improvements to real property. Therefore, the taxpayer was not liable for Wisconsin sales or use tax on its purchases of these items. Because the contractor did work for the State of Wisconsin, the contractor was not required to charge Wisconsin sales tax because the sales were exempt under sec. 77.54(9a), Wis. Stats.

Finally, section Tax 11.29(4), Wis. Adm. Code, provides that a person who uses the person's own equipment to perform a job and who assumes responsibility for its satisfactory completion shall be performing a service.

Facts and Question 1: Company ABC is engaged in the business of incidental highway construction work (in other words, it does work that is incidental to the actual road building). As part of its business, it installs barricades and temporary traffic control signs along parts of highways being constructed or repaired. Company ABC owns the barricades and temporary traffic signs and is responsible for maintaining them. Company ABC charges Contractor EFG a fee for installing the barricades and temporary traffic signs and for moving these items as necessary while Contractor EFG is repairing a highway.

Is the fee subject to Wisconsin sales or use tax as a lease or rental of tangible personal property?

Answer 1: No. Company ABC is providing a service, as described in sec. Tax 11.29(4), Wis. Adm. Code, rather than leasing tangible personal property. The service is not taxable under sec. 77.52(2)(a), Wis. Stats. (1987-88). However, Company ABC is subject to sales or use tax on equipment and supplies it purchases or uses in providing this nontaxable service.

Facts and Question 2: As another part of its business, Company ABC does paint striping on finished roadways.

Is the charge for paint striping subject to Wisconsin sales and use tax?

Answer 2: No. The paint striping is a service to real property which is not subject to sales or use tax. However, any equipment and supplies Company ABC purchases and uses in doing the paint striping are subject to sales or use tax.

Facts and Question 3: As another part of its business, Company ABC installs delineator posts, signs, and signposts after the general construction of a highway is completed. In this instance, Company ABC is a subcontractor and bills the general contractor for these items and the installation.

Is the sale and installation of the delineator posts, signs, and signposts subject to Wisconsin sales or use tax?

Answer 3: No. The delineator posts, signs, and signposts are tangible personal property, which do not become part of the realty after installation. Based on the *Tom Kuehne* decision, their sale and installation by Company ABC is for resale by the general contractor to the State of Wisconsin and are not subject to sales and use tax, provided the general contractor gives Company ABC a properly completed resale certificate. Company ABC may purchase the delineator posts, signs, and signposts and other supplies transferred to the general contractor as part of the installation without tax as property for resale.

❒

2. Motor Vehicle Adaptive Equipment for Handicapped Persons

Statutes: Section 77.54(22)(g), Wis. Stats., as created by 1989 Wisconsin Act 238 and renumbered by 1989 Wis. Act 359, effective June 1, 1990

Background: Section 77.54(22)(g), Wis. Stats., exempts:

> "Adaptive equipment that makes it possible for handicapped persons to enter, operate or leave a vehicle, as defined in s. 27.01(7)(a)2, if that equipment is purchased by the individual who will use it, a person acting directly on behalf of that individual or a nonprofit organization."

Section 27.01(7)(a)2, Wis. Stats., defines a "vehicle" as an automobile, motor truck, motor delivery wagon, motor bus, motorcycle or other similar motor vehicle.

Facts and Question 1: A van conversion company takes a new van, removes the factory roof, and installs a raised fiberglass roof and raised doorway.

The raised roof accommodates wheel chair patients by adding height, which makes it easier to transfer to the automotive seat. The raised doorway allows easier access to the van. Is the cost of these modifications exempt from sales and use tax?

Answer 1: No. A modified roof and/or doorway of a van does not qualify as "equipment" as that term is used in sec. 77.54(22)(g), Wis. Stats. Thus the cost of modifying the roof or doorway is subject to sales and use tax.

Facts and Question 2: A van conversion company adds a wheelchair lift and a hand controlled clutch, brake, and throttle to a new van. Do the lift and hand controls qualify for the exemption?

Answer 2: Yes. The lift and hand controls are exempt. A wheelchair lift is adaptive equipment which makes it possible for a handicapped person to enter or leave the van. The hand controls make it possible for a handicapped person to operate the van.

Question 3: Is adaptive equipment that would qualify for exemption under sec. 77.54(22)(g), Wis. Stats., already installed in a used vehicle and purchased as a component part of the used vehicle, by a handicapped person, exempt from sales and use tax?

Answer 3: Yes. That portion of the used vehicle purchase price reasonably allocable to the adaptive equipment is exempt under sec. 77.54(22)(g), Wis. Stats. The following may be used to determine the portion of the purchase price allocable to the adaptive equipment:

1. Purchase price of the used vehicle which contains adaptive equipment. $__________
2. Purchase price of same year, make, and model of used vehicle not containing adaptive equipment. __________
3. Subtract line 2 from line 1. This is the portion of the purchase price which is exempt from sales and use tax. $__________

As an alternative, the following formula may be used to determine the portion of the purchase price allocable to the adaptive equipment:

Original cost of adaptive equipment in the used vehicle / Total cost of the vehicle when new (including cost of the adaptive equipment)	x	Purchase price of the used vehicle and equipment	=	Portion of purchase price allocable to adaptive equipment

3. Settlement From Guarantor of Lease

Statutes: Sections 77.51(14)(j) and 77.52(1), Wis. Stats. (1987-88)

Wis. Adm. Code: Section Tax 11.29(1) and (6)(e), July 1977 Register

Facts and Question: Company ABC leases tangible personal property for a period of 5 years to a lessee in Wisconsin. The lessee files a reorganization type bankruptcy during the second year of the lease term and subsequently fails to pay on the lease. At the end of the second year of the lease term, Company ABC accepts $10,000 from the guarantor of the lease in settlement of the lease. Is the $10,000 settlement subject to sales tax?

Answer: Yes. The payment is deemed consideration arising from the original lease since it effectively decreases the term of the lease. However, any amount paid which exceeds the original lease payments due and which is specifically identified in the settlement stipulation as interest would not be subject to tax.

4. Waste Reduction and Recycling - Packaging Fertilizer Produced From Sewerage

Statutes: Section 77.54(26m), Wis. Stats. (1987-88)

Background: Section 77.54(26m), Wis. Stats. (1987-88), provides an exemption from sales and use tax for the gross receipts from the sale of and the storage, use, or other consumption of waste reduction or recycling machinery and equipment, including parts, exclusively and directly used for waste reduction or recycling activities which reduce the amount of solid waste generated, reuse solid waste, recycle solid waste, compost solid waste, or recover energy from solid waste.

Facts and Question: Company ABC has entered into a contract with a local municipal waste treatment facility to package milorganite which is produced from sewerage at the waste treatment facility. Once packaged, Company ABC will distribute the milorganite to customers who will use it as fertilizer.

Company ABC receives the milorganite from the waste treatment facility by railroad car. It cools the milorganite, if necessary, and dedusts or oils it. The milorganite is then packaged into various size containers for distribution.

Are machinery, equipment, and forklifts, including repair parts, used by Company ABC in its packaging of milorganite subject to Wisconsin sales or use tax?

Answer: The machinery, equipment, and forklifts, including repair parts, used by Company ABC to package the milorganite are exempt from Wisconsin sales and use tax under sec. 77.54(26m), Wis. Stats. (1987-88), provided Company ABC uses the machinery, equipment, and forklifts exclusively and directly in its packaging operation for the local municipal waste treatment facility or in similar operations. The packaging done by Company ABC is considered to be a waste reduction or recycling activity.

If Company ABC does not use the machinery, equipment, or forklifts exclusively for recycling or waste reduction, the exemption does not apply. "Exclusively" means that the machinery and equipment and repair parts or replacements for those machines and equipment are used solely in recycling or waste reduction activities to the exclusion of all other uses, except that the sales and use tax exemption will not be invalidated by an infrequent and sporadic use other than recycling and waste reduction.