

4. Wisconsin law requires these retirees to exhaust available state administrative remedies before commencing a sec. 1983 action in the Wisconsin courts.

The Wisconsin Supreme Court, therefore, reversed the Court of Appeals' decision which affirmed the Circuit Court's order granting injunctive relief to the plaintiffs and denying the department's motion to dismiss.

The taxpayer has appealed this decision to the United States Supreme Court.

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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:

Corporation Franchise or Income Taxes

1. Authority to Audit Federal Tax Return Information (p. 16)
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Sales/Use Taxes

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CORPORATION FRANCHISE OR INCOME TAXES

1. Authority to Audit Federal Tax Return Information

Statutes: Sections 71.26(2) and (3) and 71.74, Wis. Stats. (1989-90), and 71.11(7)(b) and (20), Wis. Stats. (1985-86)

Background: For the 1987 taxable year and thereafter, the computation of Wisconsin net income of a corporation is determined under the Internal Revenue Code, with certain modifications (sec. 71.26(2) and (3), Wis. Stats. (1989-90)). The Wisconsin corporation franchise and income tax returns (Forms 4 and 5) utilize federal taxable income before net operating losses and special deductions, which has been reported on federal Form 1120 or 1120-A, as the starting point for the determination of Wisconsin net income.

Question: Does the Wisconsin Department of Revenue have the authority to audit the information on the federal Form 1120 or 1120-A which has been utilized in determining the federal net income reported on the Wisconsin Form 4 or 5?

Answer: Yes. Section 71.74(2), Wis. Stats. (1989-90), provides that the department, for the purpose of ascertaining the correctness of any

return or for the purpose of making a determination of the taxable income of any corporation, may examine any books, papers, records or memoranda bearing on the income of the corporation. It also provides that upon such information as it may discover, the department shall determine the true amount of income received during the year or years under investigation. Therefore, the department has authority to examine all supporting documentation regarding the computation of federal net income before net operating losses and special deductions as reported on federal Form 1120 or 1120-A.

In addition, sec. 71.74(6), Wis. Stats. (1989-90), provides that whenever a corporation which is required to file a franchise or income tax return with Wisconsin is affiliated with or related to any other corporation through stock ownership by the same interests or as parent or subsidiary corporations, or whose income is regulated through contract or other arrangement, the department may require such consolidated statements as in its opinion are necessary in order to determine the taxable income received by any one of the affiliated or related corporations.

Note: Prior to the 1987 taxable year, the department had the same authority to audit and examine such return information (sec. 71.11(7)(b) and (20), Wis. Stats. (1985-86)).

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2. Wisconsin Treatment of Alaska Native Corporation Losses

Statutes: Section 71.26(3)(x), Wis. Stats. (1989-90), and sec. 71.04, Wis. Stats. (1985-86).

Background: Section 1501 of the Internal Revenue Code (IRC) provides that an affiliated group of corporations, as defined in sec. 1504(a), may file consolidated federal income tax returns. Under the consolidated return rules, the losses and tax credits generated by one corporation may be offset against income earned by another member of the affiliated group.

Section 60(b)(5) of the Deficit Reduction Act of 1984 (P.L. 98-369) amended IRC sec. 1504(a) to alter the general requirements for affiliation and add an 80 percent equity ownership test. Thus, two corporations are not eligible to file a consolidated return for a taxable year unless, at the beginning of the taxable year, one owns stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of the fair market value of all outstanding stock of the other. Under the prior federal rules, one corporation could possess 80 percent of the voting power of all classes of stock but a much smaller percentage of the value of another corporation and still file a consolidated return.

The change in the definition of an affiliated group generally became effective for taxable years beginning after December 31, 1984. However, in the case of the affiliation of a corporation with an Alaska Native Corporation (ANC), the effective date of this change was delayed until taxable years beginning in 1992. ANCs are corporations established under the Alaska Native Claims Settlement Act of 1971 (43 U.S.C. secs. 1601 et seq.) to hold the cash and land given to the Alaskan natives in settlement of their aboriginal land claims. Shares in the ANCs are held by the Alaskan natives.

Section 1804(e)(4) of the Tax Reform Act of 1986 (P.L. 99-514) amended sec. 60(b)(5) of the 1984 Act to liberalize the requirements for affiliation with an ANC or with a wholly owned subsidiary of an ANC for any taxable year beginning after 1984 and before 1992. Additionally, 1986 Act sec. 1804(e)(4) exempted ANCs from other provisions of the Internal Revenue Code, including secs. 269 and 482, and other principles of law, thus permitting them in effect to sell their losses and tax credits to a profitable corporation for a fee. The use of an ANC's tax benefits is accomplished through the affiliation of a profitable corporation with the ANC or a wholly owned ANC subsidiary, subject to the consolidated return regulations.

The Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647) eliminated the special consolidation rules applicable to ANCs, generally effective for losses and tax credits arising after April 26, 1988.

Example: In order to utilize an ANC's losses and tax credits, an ANC and a profitable corporation ("P") form a new corporation ("N"), which is capitalized with preferred stock and common stock. ANC acquires the preferred stock of N for a nominal amount of cash. P acquires the common stock in exchange for an assignment of income to N in an amount sufficient to utilize ANC's tax benefits. For federal income tax purposes, the income assigned by P to N is included in N's taxable income and excluded from P's taxable income.

Since N is affiliated with ANC, ANC includes the assigned income in the ANC group consolidated federal income tax return, offsetting that income with its own losses and tax credits. N agrees to make "tax-sharing" payments to ANC to compensate ANC for the losses and tax credits used as a result of including N in the ANC affiliated group. These payments will come from cash payments made by P to N for a portion of the income assigned. Federally, these cash payments are not taxable income to ANC and are not deductible by N or P.

When ANC's tax benefits are fully utilized, ANC's interest in N will terminate and N will be liquidated.

Question 1: May P assign income to N for Wisconsin franchise or income tax purposes?

Answer 1: No. P may not reduce the amount of income subject to Wisconsin taxation by assigning a portion of that income to N. The mechanism for assigning income to N is found in the federal consolidated return provisions, and these provisions do not apply for Wisconsin purposes.

For 1986 and prior taxable years, Wisconsin net income was not determined under the Internal Revenue Code and Wisconsin law did not contain any provision that would allow consolidated reporting or the assignment of income. Beginning with the 1987 taxable year, the Wisconsin corporation franchise and income tax law is federalized. However, secs. 1501 to 1505, 1551, 1552, 1563, and 1564, relating to consolidated returns, are specifically excluded from the Internal Revenue Code in effect for Wisconsin purposes. Sec. 71.26(3)(x), Wis. Stats. (1989-90). Therefore, a profitable corporation may not assign income to an ANC or claim losses incurred by an ANC.

Question 2: May P claim a deduction for payments actually made to N pursuant to the assignment of income agreement?

Answer 2: No. Neither the Wisconsin law in effect for 1986 and prior taxable years nor that applicable for 1987 and subsequent years contains any provision which would permit P to deduct payments made under the assignment of income agreement. Payments made in exchange for the stock in N are contributions to capital and are considered basis in the stock of N. At such time that N is liquidated, P will recognize gain or loss in accordance with that basis.

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SALES/USE TAXES

1. Credit for Sales Tax Paid in Minnesota

Statutes: Sections 77.53(16) and 77.71(2), (3), and (4), Wis. Stats. (1989-90)

Background: Section 77.53(16), Wis. Stats. (1989-90), provides a credit against Wisconsin sales or use tax for sales tax paid to another state on the sale of tangible personal property or services that is also subject to Wisconsin sales or use tax. The credit for sales tax paid to the other state cannot exceed the amount of the Wisconsin sales or use tax on the same item.

Section 77.71(2), (3), and (4), Wis. Stats. (1989-90), provides a credit against the Wisconsin county tax for any similar local tax paid in another state on the sale of tangible personal property and services that are also subject to the Wisconsin county tax. The credit for local tax paid to the other state cannot exceed the amount of the Wisconsin county tax on the same item.

Facts and Question: For all taxable sales made during the period of July 1, 1991, through December 31, 1991, the Minnesota general sales and use tax and motor vehicle excise tax rates are increased by 0.5% to 6.5%. The special tax rates for farm machinery, logging equipment, aquaculture equipment, special tooling, and liquor sales are also increased by 0.5%.

Beginning January 1, 1992, counties in Minnesota may impose a 0.5% sales and use tax on retail sales. County sales and use tax will apply to the same items subject to the 6% general sales and use tax, and to vehicles subject to the motor vehicle excise tax. This local

option tax will replace the temporary increase in the Minnesota state sales and use tax rate and will be in addition to any existing local sales taxes.

May the 0.5% additional Minnesota tax paid on sales made during the period of July 1, 1991, through December 31, 1991, be claimed as credit against the Wisconsin county sales and use tax if the sale was also subject to the Wisconsin county tax?

Answer: No. The additional 0.5% sales tax paid to Minnesota on sales made during the period of July 1, 1991, through December 31, 1991, is a *state* sales tax, even though it will be replaced by a county sales tax. Therefore, prior to January 1, 1992, the additional 0.5% Minnesota sales tax paid on the sale of tangible personal property or taxable services that is also subject to the Wisconsin sales and use tax may not be claimed as a credit against Wisconsin county tax. Effective January 1, 1992, the 0.5% local option tax may be claimed as a credit against the Wisconsin county tax.

Note: The additional 0.5% Minnesota general *state* sales tax paid on sales made during the period of July 1, 1991 through December 31, 1991, may not be claimed as a credit against the Wisconsin state sales and use tax because the Minnesota sales tax rate of 6% already exceeds the 5% Wisconsin rate.



2. Payment for Medical Equipment Under Medicare Program

Statutes: Sections 77.51(4)(b)4, 77.52(1), 77.53(1) and 77.54(1) and (22), Wis. Stats. (1989-90)

Wis. Adm. Code: Section Tax 11.45(4), March 1991 Register

Background: The Medicare program is a federal health insurance program for persons age 65 or older and certain disabled persons. One part of the Medicare program, "Medical Insurance," helps these persons pay for certain durable medical equipment.

Under the Medicare program, a person requiring medical equipment may purchase medical equipment, pay the supplier directly, and file a claim with the administrator of Medicare claims for reimbursement of an amount paid for medical equipment. Otherwise, a person requiring medical equipment may purchase medical equipment from a supplier, and the supplier will file a claim with the administrator of Medicare claims for payment of the medical equipment. The amount not paid by Medicare may be billed to the customer, with some limitations.

Medicare sets limits on the amount it will pay towards the purchase of medical equipment. Generally, Medicare will pay 80% of that limit. Suppliers of medical equipment under the Medicare program can file claims for payment by Medicare under one of two methods:

A. *Assigned.* Suppliers enter into agreements with Medicare where they agree in advance to accept assignment on all Medicare

claims. Under this agreement, the supplier accepts as total payment the amount (limit) approved by Medicare. The supplier will file a claim with the administrator of Medicare claims for 80% of the approved amount and will bill the customer for the remaining 20% of the approved amount. The Medicare program prohibits suppliers under this agreement from charging customers more than 20% of the Medicare approved amount.

Example: An item of medical equipment sells for \$1,000. The Medicare approved amount is \$900. The supplier can file a claim with the administrator of Medicare claims for \$720 (\$900 approved amount X 80%). The supplier may bill the customer for \$180 (\$900 approved amount X 20%).

B. *Unassigned.* The supplier files a claim with the administrator of Medicare claims for 80% of the approved Medicare amount. The difference between the selling price of the medical equipment and the amount paid by Medicare may be billed to the customer.

Example: An item of medical equipment sells for \$1,000. The Medicare approved amount is \$900. The supplier can file a claim with the administrator of Medicare claims for \$720 (\$900 approved amount X 80%). The supplier may bill the customer for \$280 (\$1,000 selling price less the \$720 paid by Medicare).

Facts and Question 1: Customer A purchases a hospital bed from Company B. Customer A pays Company B \$1000 for the hospital bed. Customer A files a claim with the administrator of Medicare claims for 80% of the Medicare approved amount for the hospital bed.

What are the Wisconsin sales or use tax implications of this transaction?

Answer 1: Company B's charge of \$1,000 to Customer A is subject to Wisconsin sales or use tax. The sale of tangible personal property is subject to Wisconsin sales or use tax unless a specific exemption applies. No exemption from Wisconsin sales or use tax applies to the sale of the hospital bed. Section Tax 11.45(4), Wis. Adm. Code, further provides that if a provider of a taxable item bills an individual for the taxable item and the individual then seeks reimbursement from Medicare, the entire amount billed to the individual is subject to Wisconsin sales or use tax.

Facts and Question 2: Customer A purchases a hospital bed from Company B which sells for \$1,000. The approved Medicare amount for the hospital bed is \$900. Company B does not accept assignment on Medicare claims. Company B files a claim with the administrator of Medicare claims for \$720 (\$900 X 80%) and bills Customer A \$280 (\$1,000 - \$720).

What are the Wisconsin sales and use tax implication of this transaction?

Answer 2: The charge to the administrator of Medicare claims for \$720 is not subject to Wisconsin sales or use tax. Section Tax 11.45(4), Wis. Adm. Code, provides that if the provider of a taxable

item bills the administrator of Medicare claims for a taxable item, the portion billed to Medicare is not subject to Wisconsin sales or use tax.

The charge to Customer A of \$280 is subject to Wisconsin sales or use tax.

Facts and Question 3: Customer A purchases a hospital bed from Company B which sells for \$1,000. The approved Medicare amount for the hospital bed is \$900. Company B has signed an agreement to accept assignment on all Medicare claims. Company B files a claim with the administrator of Medicare claims for \$720 (\$900 X 80%) and bills Customer A \$180 (\$900 X 20%).

What are the Wisconsin sales and use tax implications of this transaction?

Answer 3: The charge to the administrator of Medicare claims for \$720 is not subject to Wisconsin sales or use tax.

The charge to Customer A for \$180 is subject to Wisconsin sales or use tax. This is true even though Company B may not collect the tax from Customer A because the Medicare program prohibits Company B from charging more than \$180 to Customer A.

Facts and Question 4: Assume the same facts as in Facts and Question 3. Can Company B reduce its gross receipts as a result of being prohibited from collecting the Wisconsin sales or use tax on the amount billed to Customer A thereby getting a credit for the sales tax that is uncollectable?

Answer 4: No. Sections 77.52(1) and 77.53(1), Wis. Stats. (1989-90), impose a sales or use tax on the retailer for tangible personal property sold, stored, used, or consumed in Wisconsin. Under sec. 77.52(3), Wis. Stats. (1989-90), a retailer may collect the tax from the consumer or user. There is no provision that allows the retailer to reduce its gross receipts for amounts it is unable to collect from the customer.

Section 77.51(4)(b)4, Wis. Stats. (1989-90), does provide for the reduction of gross receipts for accounts found to be worthless. If the customer pays the amount billed to him or her as provided under the assigned method, the account is not worthless even though the tax may not be collected from the customer. Therefore, the reduction under sec. 77.51(4)(b)4, Wis. Stats. (1989-90), does not apply.

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3. Real Property Leases Involving Tangible Personal Property

Statutes: Sections 77.51(13)(n) and 77.52(1), Wis. Stats. (1989-90)

Wis. Adm. Code: Sections Tax 11.29, June 1991 Register, and 11.48, March 1991 Register

Background: Section 77.52(1), Wis. Stats. (1989-90), imposes a sales tax on receipts from leasing or renting tangible personal prop-

erty at retail in Wisconsin. Special rules may apply when tangible personal property is included in a lease of real property.

Section 77.51(13)(n), Wis. Stats. (1989-90), provides that "retailer" includes a person selling household furniture, furnishings, equipment, appliances, or other items of tangible personal property to a landlord for use by tenants in leased or rented living quarters.

Facts and Question 1: A landlord rents furnished apartments for \$600 a month and unfurnished apartments for \$550 a month. In addition to a stove and refrigerator, which are provided in all apartments, living room and bedroom furniture are provided in furnished apartments. Is any portion of the landlord's rental receipts subject to sales tax?

Answer 1: No. The landlord's rental receipts are not subject to sales tax, even though a different amount is charged for furnished apartments. Section Tax 11.48(1)(a), Wis. Adm. Code, provides that the landlord is considered the consumer of the appliances and furniture and is subject to sales or use tax when purchasing these items.

Facts and Question 2: ABC Co. rents furniture, appliances, and other household items to persons who own their homes or live in apartments, and to landlords who use the items in residential rental property. Are ABC Co.'s rental receipts subject to sales tax?

Answer 2: Yes. ABC's receipts from the rental of furniture, appliances, and other household items are subject to sales tax.

Facts and Question 3: Restaurant Operator A decides to discontinue her business. She owns the building and trade fixtures (tangible personal property such as cooking equipment, coolers, and furniture). She will lease the entire business, including real property and tangible personal property, to Restaurant Operator B. Is any portion of Restaurant Operator A's lease receipts subject to sales tax?

Answer 3: Yes. The portion of the lease receipts attributable to the tangible personal property is subject to sales tax.

Note: Restaurant Operator A must hold a seller's permit for the collection and payment of sales tax on the taxable portion of the lease receipts.

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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 "W" is for "Wisconsin," the first two digits are the year the ruling