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

1 Effect of Wisconsin Martial Property Law Where Spouses Have Separate Domiciles

Statutes: Section 71.10(6)(d), Wis. Stats. (1991-92)

Background: Section 71.10(6)(d), Wis. Stats. (1991-92), provides that for Wisconsin income tax purposes, marital property law applies only for the period of time during which both spouses are domiciled in Wisconsin.

During any period that both husband and wife are domiciled in Wisconsin, income subject to Wisconsin tax is reported under marital property law. If separate Wisconsin income tax returns are filed, each spouse would report half of the combined marital property income, deductions, and credits and all of his or her own individual income deductions and credits. (See Publication 109, Tax Information for Married Persons Filing Separate Returns and Persons Divorced in 1992, or Publication 113, Federal and Wisconsin Income Tax Reporting Under the Marital Property Act, for more information on marital income.)

During any period in which the husband and wife are not both domiciled in Wisconsin, income subject to Wisconsin tax is reported based on title and ownership under the common law property system.

Example: The wife is a full-year Wisconsin resident and the husband is a full-year Iowa resident for 1992. The wife earned wages of $10,000 from employment in Wisconsin. The husband was self-employed in Iowa and had self-employment income of $30,000. These types of income would generally be marital property income reportable half ($20,000) by each spouse. However, because one spouse is a nonresident, the marital property law doesn't apply. The husband and wife may file a joint return (Form 1NPR) for Wisconsin or the wife may file a separate Wisconsin return (Form 1). The husband is not required to file a separate Wisconsin return. Regardless of whether the joint or separate return is filed, only the wife's wages of $10,000 from her employment in Wisconsin are reportable to Wisconsin. (Note: If both spouses are nonresidents of Wisconsin, Form 1NPR is filed regardless of whether a joint or separate return is filed.)

Facts and Question: The facts are the same as in the above example except that the husband is a full-year resident of Arizona, which is a community property state. Does the fact that the nonresident spouse is a resident of a community property state have any affect on the amount of

income taxable to Wisconsin by the resident spouse?

Answer: No. The fact that the nonresident spouse is a resident of a community property state has no affect on the amount of income taxable to Wisconsin by the Wisconsin resident spouse. In the above example, only the wife's wages of $10,000 are taxable by Wisconsin, regardless of whether the husband is a resident of Iowa (a non-community property state) or Arizona (a community property state). □

2 Wisconsin Tax Treatment of Designated Settlement Funds

Statutes: Sections 71.01(5), 71.22(1), and 71.23, Wis. Stats. (1991-92)

Background: For federal income tax purposes, a "designated settlement fund" means any fund:

- established pursuant to a court order for the purpose of completely extinguishing a taxpayer's tort liability with respect to claims arising out of personal injury, death, or property damage;
- established for the principal purpose of resolving and satisfying present and future claims against a taxpayer, or any related person, arising out of personal injury, death, or property damage;
- administered by persons a majority of whom are independent of the taxpayer;
- funded only by transfers of qualified payments;
- in which the taxpayer, or any related person, has no beneficial interest in the income or corpus of the fund; and
- for which the taxpayer has made an election under sec. 468B of the Internal Revenue Code.

A designated settlement fund is taxed as a separate entity at the maximum federal rate applicable to trusts. The gross income of a designated settlement fund includes income from the investment of the fund's assets, but not "qualified payments" made to the fund. The only deductions allowed to the fund are administrative costs, including state and local taxes, and other incidental expenses of the fund, including legal, accounting, and actuarial expenses. To be deductible, the expenses must be incurred in connection with the operation of the fund and must be deductible in determining the taxable income of a corporation.

A designated settlement fund reports its income, deductions, and tax on federal Form 1120-DF, U.S. Income Tax Return for Designated Settlement Funds (Under Section 468B). For purposes of the administration of the federal income tax laws, a designated settlement fund is treated as a corporation.

Facts and Question: Wisconsin law does not specifically address the treatment of a designated settlement fund. There is no provision in the statutes to treat a designated settlement fund as a corporation.

What is the Wisconsin income tax treatment of a designated settlement fund?

Answer: For Wisconsin income tax purposes, a designated settlement fund is treated as a fiduciary, a trust. Therefore, the filing requirements, Wisconsin income computation, and administrative provisions for fiduciaries also apply to a designated settlement fund. The fund calculates its Wisconsin income tax using the rates applicable to fiduciaries in sec. 71.06(1), Wis. Stats. (1991-92). A designated settlement fund reports its Wisconsin net income and tax on Wisconsin Form 2, Fiduciary Income Tax Return.

Subchapters I and II of Chapter 71 of the Wisconsin Statutes provide for the taxation of individuals and fiduciaries. Under sec. 71.01(5), Wis. Stats. (1991-92), "fiduciary" has the same meaning as in the Internal Revenue Code. For federal income tax purposes, a fiduciary is a "guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person." □

FARMLAND PRESERVATION CREDIT

3 Farmland Preservation Credit Eligibility and Paybacks for Transferred Property

Statutes: Sections 71.58(8) and 71.59(1)(b)(intro.) and 2 and (2)(a), Wis. Stats. (1991-92)

Background: Beginning with the 1991 taxable year, a farmland preservation credit claim may be filed any time up to four years after the unextended due date of the corresponding tax return. Section 71.59(2)(a), Wis. Stats. (1991-92). The computation of a farmland preservation credit is based in part on a claimant's property taxes accrued. Property taxes accrued are taxes levied on farmland and improvements owned by the claimant or the claimant's household during the year to which the claim relates. Section 71.58(8), Wis. Stats. (1991-92). One of the qualifications for receiving farmland preservation credit is that the property taxes for the year prior to the year to which the claim relates must be paid. Section 71.59(1)(b)(intro.) and 2, Wis. Stats. (1991-92).

Farmland preservation credit may be based either on farmland subject to exclusive agricultural use zoning, or on farmland subject to a farmland preservation agreement or a transition area agreement. If farmland is rezoned or an agreement is relinquished, secs. 91.19(7) and (8) and 91.77(2), Wis. Stats. (1991-92), provide that under certain circumstances a lien may be recorded against the property, for the total amount of farmland preservation credits received by all owners of the farmland during the last 10 years the land was eligible for the credits.

Facts: Farmer A owns farmland subject to exclusive agricultural use zoning in 1991. He has not paid his 1990 property taxes but otherwise qualifies for farmland preservation credit for 1991. In 1992 Farmer A sells the farmland to Farmer B, and Farmer B pays the delinquent 1990 taxes. In 1998, Farmer B has the land rezoned.

Question 1: After Farmer B pays the 1990 property taxes in 1992, may Farmer A file a 1991 farmland preservation credit claim, even though the prior year's taxes were paid by somebody else, and even though Farmer A no longer owns the property?

Answer 1: Yes. Since the requirement that the 1990 property taxes be paid has now been met and Farmer A meets all the other filing requirements, he may claim a 1991 credit any time before the filing deadline. There is no requirement that Farmer A must be the one to have paid the 1990 property taxes or that he must be the owner of the property at the time of filing the claim.

Question 2: After the land is rezoned, is Farmer B subject to the lien provisions, even though he never received any farmland preservation credits, and at the time he purchased the farmland there were no credits previously allowed on the farmland?

Answer 2: Yes. The lien provisions apply to the owner of the farmland at the time an agreement is relinquished or land is rezoned, regardless of who received the farmland preservation credits, and regardless of whether any credits had been allowed on the land at the time of its purchase. □

CORPORATION FRANCHISE AND INCOME TAXES

4 Accelerated Cost Recovery System (ACRS) Deductions

Statutes: Sections 71.01(4)(g)7 to 10, 71.02(1)(c)8 to 11, and 71.04(15), Wis. Stats. (1985-86), and secs. 71.26(2) and (3)(y), 71.365(1m), and 71.45(2)(a)7, Wis. Stats. (1991-92)

Note: This tax release applies to all corporations, other than certain public utilities, required to file a Wisconsin franchise or income tax return. It does not apply to telegraph, pipeline, gas, electric, steam, and telephone companies (as defined under sec. 76.02(4), Wis. Stats. (1983-84), and secs. 76.02(5b), 76.28(1)(e)1, 3, and 4, and 76.38(1)(c), Wis. Stats. (1985-86), except for specialized common carriers).

Background: Section 71.04(15)(b), Wis. Stats. (1985-86), provided in part that property located outside Wisconsin, and first placed in service on or after January 1, 1983, shall be depreciated under the Internal Revenue Code as amended to December 31, 1980, or under the Code as applicable to the determination of net income for 1972, at the option of the corporation. This applies to all corporations, including regular (C) corporations, insurance companies, tax-option (S) corporations, regulated investment companies, and real estate investment trusts.

Sections 71.26(3)(y), 71.365(1m), and 71.45(2)(a)7, Wis. Stats. (1991-92), provide in part that property first placed in service between January 1, 1983, and December 31, 1986, that was depreciated under sec. 71.04(15)(b), Wis. Stats. (1985-86), must continue to be depreciated under the Code as amended to December 31, 1980.

Section 71.26(2)(a), Wis. Stats. (1991-92), provides in part that, in determining Wisconsin net income, federal net income must be adjusted (plus or minus) for an amount equal to the difference between the federal basis and Wisconsin basis of any asset sold, exchanged, abandoned, or otherwise disposed of in a taxable transaction during the taxable year.

These statutes specifically disallowed accelerated cost recovery system ("ACRS") deductions on certain property located outside Wisconsin.

In its decision in *Beatrice Cheese, Inc. vs. Wisconsin Department of Revenue* (February 24, 1993), the Wisconsin Tax Appeals Commission ruled that sec. 71.04(15)(b), Wis. Stats. (1985-86), and sec. 71.26(3)(y), Wis. Stats. (1991-92), discriminate against interstate commerce by providing a direct commercial advantage to businesses whose depreciable property is located in Wisconsin, in violation of the Commerce Clause of the United States Constitution.

The Commission stated that the effect of this differential treatment is to impose a higher franchise tax burden on a business solely because some or all of its depreciable property is located outside Wisconsin rather than in Wisconsin. It further stated this is clearly facial discrimination against

interstate commerce. The department has not appealed this decision.

Accordingly, a taxpayer may claim deductions under ACRS on assets located outside Wisconsin and placed in service in any year that ACRS is allowable under the Internal Revenue Code. However, if any years during which another depreciation method was utilized for Wisconsin franchise or income tax purposes are closed to adjustment by the statute of limitations, the difference between the federal and Wisconsin basis of an asset may not be accounted for until the asset is disposed of in a taxable transaction.

A taxpayer is not required to claim a deduction under ACRS. The depreciation method originally claimed, assuming it was properly determined, may be continued until the asset is fully depreciated, or is no longer in service.

Facts and Question 1: Corporation A filed its Wisconsin returns for the years 1983 through 1991 and claimed deductions under ACRS on all out-of-state property. The years 1983 through 1988 are closed to adjustment pursuant to sec. 71.77(2), Wis. Stats. (1991-92).

What does Corporation A need to do as a result of the *Beatrice Cheese Co.* decision?

Answer 1: No adjustments to Corporation A's returns are necessary. Although Corporation A filed its returns without complying with the provisions of sec. 71.04(15)(b), Wis. Stats. (1985-86), and sec. 71.26(3)(y), Wis. Stats. (1991-92), these sections were ruled to be unconstitutional by the Wisconsin Tax Appeals Commission. Therefore, Corporation A may continue to claim ACRS deductions on the property.

Facts and Questions 2: Corporation A filed its Wisconsin returns for the years 1983 through 1991 and claimed deductions under ACRS on all out-of-state property. All of the years are open to adjustment by a written agreement pursuant to sec. 71.77(5), Wis. Stats. (1991-92).

What adjustments, if any, will the department make to correct the old taxpayer's depreciation deduction upon completion of its audit?

Answer 2: The department will make no adjustments to place the taxpayer in compliance with sec. 71.04(15)(b), Wis. Stats. (1985-86), and sec. 71.26(3)(y), Wis. Stats. (1991-92), since these sections have been declared unconstitutional. However, the department could adjust a depreciation deduction to the extent it is not computed in compliance with the provisions of the Internal Revenue Code.

Facts and Question 3: Corporation A filed its Wisconsin returns for the years 1983 through 1991 and claimed deductions under ACRS on all out-of-state property. The years 1983 through 1990 were audited by the department and adjustments were made to the depreciation claimed in order to put the taxpayer in compliance with sec. 71.04(15)(b), Wis. Stats. (1985-86), and sec. 71.26(3)(y), Wis. Stats. (1991-92). The assessment for the years 1983 through 1986 was paid, without appeal, on April 30, 1989. The assessment for the years 1987 through 1990 was issued April 15, 1992, and was paid, without appeal, on May 31, 1992. The taxpayer filed returns for the years 1991 and 1992, making the adjustments to depreciation in accordance with sec. 71.26(3)(y), Wis. Stats. (1991-92).

What are the taxpayer's options as the result of the *Beatrice Cheese* decision?

Answer 3: The years 1983 through 1986 are closed to refund pursuant to sec. 71.75(2), Wis. Stats. (1991-92). The years 1987 through 1990 are open to refund claims until April 15, 1994, pursuant to sec. 71.75(5), Wis. Stats. (1991-92). The years 1991 and 1992 are open to refund claims pursuant to sec. 71.75(2), Wis. Stats. (1991-92).

The refund claims for the years 1987 through 1990 are limited to the deductions disallowed as part of the prior field audit. The asset basis differences, resulting from unclaimed or disallowed depreciation due to the difference between ACRS depreciation and the method allowed, will not be allowed as a deduction, or taken into income, until such time that the assets are sold, exchanged, abandoned, or otherwise disposed of in a taxable transaction.

The taxpayer's 1991 and 1992 adjustments to federal net income for differences in Wisconsin and federal depreciation may be reversed if the taxpayer elects to file amended returns for these years.

In the alternative, the taxpayer may elect to continue its present method of depreciation until the assets are fully depreciated or disposition occurs.

Facts and Question 4: Corporation B filed its returns for the years 1983 through 1992 in accordance with sec. 71.04(15)(b), Wis. Stats. (1985-86), and sec. 71.26(3)(y), Wis. Stats. (1991-92). The taxpayer was audited for all years 1983 through 1990 with an assessment issued January 13, 1992, and paid March 1, 1992. The department made no adjustments to depreciation.

What are the options available to Corporation B?

Answer 4: Since no depreciation adjustments were made by the depart-

ment upon field audit, the years 1983 through 1990 are closed to refund claims pursuant to sec. 71.75(4), Wis. Stats. (1991-92).

The taxpayer may file amended returns for 1991 and 1992 to reverse its adjustments for depreciation made as a result of sec. 71.26(3)(y), Wis. Stats. (1991-92). However, the differences in federal and Wisconsin basis at the end of 1990, due to adjustments for depreciation, may not be recovered until the assets are sold, exchanged, abandoned, or otherwise disposed of in a taxable transaction.

As an alternative, the taxpayer may continue its current depreciation method for future years until the assets are fully depreciated or disposed of in a taxable transaction.

Facts and Question 5: Corporation B filed its returns for the years 1983 through 1992 in accordance with sec. 71.04(15)(b), Wis. Stats. (1985-86), and sec. 71.26(3)(y), Wis. Stats. (1991-92). The years 1983 through 1990 are still open to adjustment under a written agreement pursuant to sec. 71.77(5), Wis. Stats. (1991-92).

What are the taxpayer's options?

Answer 5: The taxpayer may file amended returns for all years (1983 through 1992) revising the adjustments for differences in federal and Wisconsin depreciation and basis due to the different depreciation methods. The years 1983 through 1988 are open for filing refund claims since the written agreement permits a taxpayer to file for a refund as well as permitting the department to make adjustments.

If the taxpayer wishes to continue its present method of depreciation, it would have that option.

Facts and Question 6: Corporation B filed its returns for the years 1983 through 1992 in accordance with sec. 71.04(15)(b), Wis. Stats. (1985-86), and sec. 71.26(3)(y), Wis. Stats. (1991-92). The taxpayer was audited for the years 1983 through 1988 with an assessment issued January 13, 1992, and paid March 1, 1992. The department made no adjustments to depreciation.

What are the taxpayer's options?

Answer 6: The taxpayer may continue to claim depreciation under sec. 71.26(3)(y), Wis. Stats. (1991-92), and account for basis differences upon the taxable disposition of the assets, pursuant to sec. 71.26(2), Wis. Stats. (1991-92).

The taxpayer's alternative is to file amended returns for the years 1989 through 1992 reversing the adjustments for the differences in Wisconsin and federal net income due to the different depreciation methods. The basis differences created by adjustments for years 1983 through 1988 will be taken into account in computing net income only at the time of disposition of the assets in a taxable transaction. □

5 Making or Withdrawing an Election Not to Be a Tax-Option (S) Corporation for Wisconsin

Statutes: Section 71.365(4), Wis. Stats. (1991-92)

Note: This tax release supersedes the tax release titled "Withdrawal of Election Not to Be a Tax-Option (S) Corporation for Wisconsin," which was published in *Wisconsin Tax Bulletin* 57 (July 1988), page 16.

Background: Beginning with the 1987 taxable year, a corporation that is an S corporation for federal income tax purposes may elect not to be a tax-option (S) corporation for Wisconsin franchise or income tax purposes. This "opt-out" election requires the consent of persons who hold more than 50% of the shares of the tax-option (S) corporation on the day on which the "opt-out" election is made.

The election is made by filing Wisconsin Form 5E, "Election by an S Corporation Not to Be Treated as a Tax-Option (S) Corporation," on or before the due date or extended due date of the corporation's Wisconsin franchise or income tax return for the first year affected by the election. Once the election is competed, the corporation or its successor may not claim Wisconsin tax-option status for the next 4 taxable years after the taxable year to which the "opt-out" election first applies. Corporations which make the "opt-out" election are treated as regular (C) corporations for Wisconsin and must file Wisconsin Form 4 or 5 rather than Form 5S.

Facts and Question 1: Corporation X, a calendar year S corporation, files a properly completed Form 5E with the department on February 1, 1993, for the 1992 taxable year. It has not yet filed its 1992 Wisconsin corporation franchise or income tax return, which is due March 15, 1993.

May Corporation X withdraw the "opt-out" election prior to the date that it files its Wisconsin corporation franchise or income tax return?

Answer 1: Yes. An "opt-out" election is not completed until the filing of a Wisconsin corporation franchise or income tax return for the first taxable year affected by the "opt-out" election. To withdraw the election, Corporation X should send a letter to the department requesting the withdrawal. The letter must contain the signatures of shareholders who hold more than 50% of the shares of the corporation.