signs and specifications, or to test and evaluate a proposed product, the primary objective of the customer is to obtain the results of the technical skill and the experimental and research work of the engineers and other technicians of the researcher.

2.In certain instances under a research and development contract, the information cannot be developed without the production of a prototype. In this situation, the researcher owes tax on the materials used to construct the prototype since it is used to compile the data, designs, drawings and whatever else is provided to the customer. The measure of the tax is the cost of the materials going into the production ~~for~~ of the prototype as well as all other materials consumed in performing the contract. The transfer of the prototype is incidental to the transfer of information, and for sales tax purposes, is deemed not a sale of tangible personal property. However, if the prototype is transferred to a customer for use in its business or for the purpose of reselling it, the researcher may purchase the materials used to construct the prototype without tax as property for resale.

(3)(g) *Architects.* Fees paid to architects, except fees paid to architects for landscaping planning, to design buildings or structures are for services performed, and are not subject to the tax. If, however, an architect has blueprints made from original drawings, the sale of the blueprints is subject to the tax.

(3)(L) *Taxidermists.* ~~Taxidermists~~ Gross receipts from services taxidermists perform ~~service~~ on tangible personal property~~. Gross receipts from such service~~ are subject to the tax.

(3)(m) *Car washes.* The gross receipts of persons providing car wash service, including those providing coin-operated self-service car washes consisting of a pressurized spray of soap and water, are taxable. ~~Such~~ These persons are the consumers of the tangible personal property, such as soap, brushes, and towels, they purchase, except for the wax, air freshener and protectants physically transferred to a customer's vehicle. Thus, suppliers may accept a resale certificate for wax, air freshener and protectants sold to car wash operators, but suppliers are liable for the tax on all other sales of supplies to ~~such~~ these operators.

(3)(n) *Soliciting advertising for telephone directories.* Persons who solicit advertising for telephone books and who, as an incident of ~~such~~ the service, provide telephone books to telephone companies or their subscribers, are the consumers of and shall pay tax on all the telephone books they distribute in Wisconsin ~~or have shipped into Wisconsin by an out of state supplier~~. □

Report on Litigation

Summarized below are recent significant Wisconsin Tax Appeals Commission (WTAC) and Wisconsin Court decisions. The last paragraph of each decision indicates whether the case has been appealed to a higher Court.

The following decisions are included:

INDIVIDUAL INCOME TAXES

Interest — deduction limitation. *Robert and Margaret Yunker vs. Wisconsin Department of Revenue* (Circuit Court for Milwaukee County, May 3, 1993). The issue in this case is whether interest paid by the taxpayer was 1) a fully deductible business expense incurred in the taxpayer's real estate business or 2) incurred by the taxpayer to acquire rental or investment property, deductible only on federal Schedule A (Itemized Deductions) as non-business interest and, therefore, subject to the $1200 interest deduction limitation contained in sec. 71.07(5)(a)7, Wis. Stats.

This is a review of a decision of the Wisconsin Tax Appeals Commission (Commission). The Commission affirmed a decision of the department denying the taxpayers a redetermination of an income tax assessment for the years 1986, 1987, and 1988.

The taxpayer, R. Yunker, is in the business of real estate investment, including the building, renting, buying, and selling of real estate. The assessment at issue involves a 120-unit apartment complex owned and operated by the taxpayer. For a period of approximately eight years, from the time the taxpayer built the complex until he sold it in 1982, he rented out the units.

The taxpayer reported the rental income, expenses, and depreciation from the property at issue on Schedule E of his tax returns. In addition, he reported the gain from the sale of the property as a sec. 1231 capital gain. Thus, the taxpayer characterized the property as investment property as opposed to property used in a trade or business.

The Commission determined that the Fond du Lac apartment complex was held by the taxpayer primarily as an investment for revenue and speculation. This finding of fact was supported by substantial evidence in the record. The taxpayer collected rents from the property for seven years and put forth no evidence that he had held the property out for sale other than his own testimony. The taxpayer's tax returns for the years in question also clearly support the Commission's findings that the property was for investment rather than for business purposes.

The Circuit Court concluded that the finding of the Commission is based upon substantial evidence. The property at issue is considered investment property, and interest incurred by the taxpayer is subject to the $1200 interest deduction limitation.

The taxpayers have appealed this decision to the Court of Appeals. □

Nonresidents — allocation of income. *Thomas J. Flynn vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, August 5, 1993). The issue in this case is the amount of the taxpayer's income which may be assessed by Wisconsin.

In 1984 and 1985, the taxpayer was a professional football player employed by the Green Bay Packers, Inc. In these years, the taxpayer was a nonresident of Wisconsin and was a resident of Pennsylvania.

The taxpayer filed 1984 and 1985 Wisconsin income tax returns as a nonresident. In November 1988, the department adjusted the income reported on these returns, providing the following explanation:

> Your Wisconsin wages from the Packers is based on a ratio of Wisconsin duty days over total regular season duty days. The ratio is normally around 90%. Duty days include practice days, meeting days, and travel days in addition to game days. In 1984 the Packers calculated a ratio of 91.5%. In 1985 the ratio was 86%. Therefore your Packer wages taxable by Wisconsin are $89,485.00 for 1984 and $161,894.65 for 1985. These wages less your IRA contributions are your only income taxable by Wisconsin.

The department also adjusted the deductions claimed by the taxpayer, as well as the exemptions claimed.

In the taxpayer's petition for redetermination, the following statements were made about the 1984 wages reported: "Taxpayer claimed Wisconsin compensation for all those games played in Wisconsin which was 8 of 16 games or 50%. Therefore, taxable Wisconsin income was claimed in the amount of $48,899 (i.e., 50% of $97,797.14). Taxpayer claimed the remaining 50% or $48,899 as Pennsylvania wages ..."

In the taxpayer's petition for redetermination, the following statements were made about the 1985 wages reported: "Taxpayer claimed Wisconsin compensation for all but $26,456.00 of his income. This represents 14% of his total income (i.e., 86% was claimed as Wisconsin income.) Taxpayer declared this as Wisconsin income even though only 50% of the income was actually earned in Wisconsin ... Taxpayer declared the remainder of his income as Pennsylvania income."

A standard rider attached to the taxpayer's contract provided for the payment of a $75,000 signing bonus, $35,000 of which was paid to the taxpayer during 1984 and 1985, and was included by the department in arriving at the taxpayer's Wisconsin taxable income.

The taxpayer claimed the signing bonus was not compensation for personal services performed in Wisconsin and therefore not subject to Wisconsin tax. He testified that during the off-season in 1985, he conditioned himself while in Pennsylvania by participating in a strength and conditioning program which was specifically provided to him by the Packers' organization. He raised the issue of whether the off-season conditioning program he pursued while in Pennsylvania constituted personal services performed outside the state of Wisconsin, thereby reducing the percentage of his compensation subject to taxation by the department under secs. 71.01 and 71.07, Wis. Stats.

The Commission concluded that:

Although the signing bonus issue was improperly raised at the hearing by the taxpayer, the bonus is clearly personal service income and taxable in the same manner as the taxpayer's other compensation.

The off-season conditioning program pursued by the taxpayer while in Pennsylvania was not a service for which he was compensated by the Green Bay Packers and was therefore properly disregarded in the department's assessment methodology. The department properly included both the pre-season and regular season duty days in apportioning the taxpayer's income to Wisconsin.

The taxpayer has appealed this decision to the Circuit Court. □

CORPORATION FRANCHISE AND INCOME TAXES

Accounting — 1986 and prior — change in accounting period; Interest income - 1986 and prior — U.S. obligations. *M.B. Investment Corp., vs. Wisconsin Department of Revenue* (Circuit Court for Milwaukee County, May 5, 1993, amended May 25, 1993).

The issue in this case is whether the taxpayer's final tax return for the period from September 1, 1985, through May 31, 1986, should be treated as a tax year 1985 return or a tax year 1986 return. The taxpayer appeals a decision of the Wisconsin Tax Appeals Commission (Commission) that the taxpayer's final return was for tax year 1986. For a summary of that decision, see *Wisconsin Tax Bulletin* 81 (April 1993), page 10.

The taxpayer filed a 1985 tax return for the period ending August 31, 1985. From September 1, 1985, through March 31, 1986, the taxpayer invested in U.S. Government securities. On May 31, 1986, the taxpayer dissolved as a corporation and filed a final Form 5, Wisconsin Corporation Income Tax Return, for the period between September 1, 1985, and May 31, 1986. On this tax return the taxpayers reported the interest income from U.S. Government securities as tax exempt pursuant to sec. Tax 2.65, Wis. Adm. Code.

The department sent notice to the taxpayer of an amount due in May 1987, based on 1985 Wisconsin Act 261. Effective for the 1986 tax year, the Act assessed corporations that had ceased doing business in Wisconsin, a special franchise tax based on the entire net income for the year in which the corporation dissolves.

The Circuit Court concluded that the taxpayer's final return was for tax year 1986. The decision of the Commission was reasonable based on the facts that the taxpayer had already filed a 1985 return and sec. 71.10(3m)(b), Wis. Stats., provides that "[i]n no case shall a separate income tax return be made for a period of more then 12 months."

The taxpayer has not appealed this decision. □

SALES AND USE TAXES

Occasional sales — business assets. *Carrion Corporation vs. Wisconsin Department of Revenue* (Court of Appeals, District IV, September 9, 1993). The taxpayer appeals from an order of the Circuit Court for Dane County affirming a decision of the Wisconsin Tax Appeals Commission. See *Wisconsin Tax Bulletin* 79 (October 1992), page 15, for a summary of the Circuit Court decision.

The Commission upheld a sales and use tax assessment against Carrion in connection with sales of the assets of its commercial and retail laundry divisions.

The issues are:

A. Whether the taxpayer's sales of its retail and commercial divisions qualified as "occasional sales" and were, thus, exempt from sales and use tax;

B. Whether the Commission properly taxed the entire asset sale proceeds;

C. Whether the Commission erroneously valued the amount of tangible property included in the sale of the taxpayer's commercial division;

D. Whether the true seller of the retail and commercial divisions was the bank or the taxpayer;

E. Whether certain equipment sales should have been excluded from the assessment because they were made to out-of-state buyers;

F. Whether the Commission erroneously assessed use taxes on the taxpayer's purchases of materials from out-of-state vendors; and

G. Whether the taxpayer should have been assessed a negligence penalty on the equipment sales in Issue E and on the equipment purchases in Issue F.

Prior to February 1983, the taxpayer's commercial division was engaged primarily in providing laundry and dry cleaning service to hospitals and nursing homes through a pickup and delivery service. The taxpayer's retail division provided laundry and dry-cleaning service for hotels and restaurants and served the general public through several retail outlets and truck routes.

In mid-1982, the taxpayer, under pressure from First Wisconsin National Bank, changed its leadership and moved to sell its laundry business and liquidate its assets.

On January 17, 1983, the taxpayer sold the retail division to D.S. Nicholas of Wisconsin, Inc. (Nicholas), for $1,401,618.04 -- $40,000 of which was paid in cash and the remainder to be paid over time pursuant to a promissory note. Of this price, $602,553 was allocated to tangible personal property. Nicholas never paid any of the principal of the promissory note.

On February 18, 1983, the taxpayer sold its commercial division to Tousey Laundry Corp. for $600,000; $400,000 of the sales price was allocated to tangible personal property, and the entire amount was to be paid pursuant to a promissory note. While Nicholas never made any principal payments, and Tousey paid only $200,000 to $300,000 on its note, First Wisconsin provided full credit to the taxpayer on both notes.

Less than an hour before finalizing the Nicholas sale on January 17, 1983, the taxpayer surrendered its seller's permit to the department, assuming that, by doing so, it would qualify the sales of both divisions as "occasional sales" not made in the course of its business as a seller of personal property or services within the meaning of sec. 77.51(10)(a), Wis. Stats., and, thus, be exempt from the sales tax.

The department issued a sales and use tax assessment against the taxpayer as follows:

1. $30,126.65 in sales taxes on the sale of the retail division's tangible personal property;

2. $22,905 in sales taxes on the sale of the commercial division's tangible personal property;

3. $5,883.34 in sales taxes on the sale of $145,850 worth of miscellaneous equipment between October 1981 and October 1982; and

4. $7,993.92 in use taxes on the taxpayer's out-of-state purchases of $197,805 of tangible property.

5. The department also imposed a twenty-five percent penalty on items (3) and (4) under sec. 77.60(3), Wis. Stats.

The Court of Appeals affirmed the Circuit Court's decision, concluding that:

A. Substantial evidence supports the Commission's conclusion that the taxpayer was required to hold a seller's permit at the time of the asset sale and did not qualify for the occasional sale exemption.

B. The Commission's determination that tax was due on the entire value of the notes is supported by substantial evidence.

C. Substantial evidence supports the $458,100 measure of sales tax.

D. Substantial evidence supports the Commission's finding that the taxpayer was the true seller of the retail and commercial divisions.

E. No credible evidence was presented to support the taxpayer's claim that certain sales were made outside Wisconsin.

F. The department auditor's testimony as to reliance on purchase journals provides sufficient evidence to support the Commission's findings, because the taxpayer's vendors were not charging the tax in 1981 and 1982 and the taxpayer could not produce invoices to show that the purchases in 1979 and 1980 were treated differently.

G. The Commission correctly rejected the taxpayer's argument, concluding that the taxpayer had failed to meet its burden of establishing error in the department's assessment.

The taxpayer filed a petition for review to the Wisconsin Supreme Court. The petition for review was denied. □

GIFT TAXES

Interest — foregone interest. *Home Juice Co., Inc.; Kenosha Home Juice Sales Corp. and Milton Hess vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, August 16, 1993). The central issue in this case is whether the taxpayers are liable for gift tax on interest foregone, or not charged, on several demand loans made by two Wisconsin corporations to the controlling shareholder of each corporation. The taxpayers include both creditor corporations and the debtor shareholder.

Complicating the central issue, however, is the issue of whether Internal Revenue Code (IRC) sec. 7872, dealing with below market interest rate loans, is applicable to deemed "transfers" of foregone interest in a corporation-to-shareholder loan setting.

Home Juice Co., Inc. ("HJCI") was, at all times during the years 1982 through 1987 ("the period under review"), a Wisconsin corporation, in business as a broker/distributor of bottled fruit juice products, and taxed under Subchapter S of the Internal Revenue Code.

Kenosha Home Juice Sales Corp. ("Sales Corp.") was, at all times during the period under review, a Wisconsin corporation, in business as a wholesaler of bottled fruit juice

products, and taxed under Subchapter C of the Internal Revenue Code.

Milton Hess ("Hess") was, at all times during the period under review, the sole shareholder of HJCI and the beneficial owner of 100% of Sales Corp.

During the period under review, Sales Corp. and HJCI made interest-free demand loans ("the loans") to Hess, documented in the form of notes; each of the notes disclosing no collateral, bearing no interest, and indicating no set duration or term. Hess made payments on the loans annually to the corporations, and all loans were fully repaid by the end of 1989.

In February 1990, the department issued gift tax assessments to Hess, asserting that because interest was not charged on the loans, Sales Corp. and HJCI made gifts to Hess of the amount of interest not charged.

Also in February 1990, the department sent "donor copies" of the respective assessments to Sales Corp. and HJCI in which it asserted joint and several liability for the alleged Wisconsin gift tax deficiencies against the corporations.

In July 1992, the Wisconsin Tax Appeals Commission issued an order withdrawing all assessments against the taxpayers for the year 1987. The department requested the withdrawal pursuant to Wisconsin's adoption of sec. 7872 of the Internal Revenue Code through Wisconsin's 1985 update of the individual income tax law to embrace changes in the IRC. IRC sec. 7872 was first made effective for federal tax purposes for certain loans in existence as of June 6, 1984. The department maintains that IRC sec. 7872 was not made effective for Wisconsin corporate income or franchise tax purposes until the 1987 Wisconsin tax year, while acknowledging that sec. 7872 was in effect for Wisconsin individual income taxpayers for 1985 and succeeding Wisconsin tax years. Accordingly, the department contends that prior to the tax periods for which sec. 7872 was made effective in Wisconsin's income tax statutes for all taxpayers, corporate and individual, deemed transfers of foregone interest among the taxpayers may not necessarily be construed to carry Wisconsin income taxation effects. Further, the finding of an income tax effect for the transfers at issue in this case does not necessarily preclude the concurrent reach of the gift tax to the deemed transfers of foregone interest.

The taxpayers contend that IRC sec. 7872 was made applicable for Wisconsin tax purposes to the loan transactions at issue in this case beginning in 1985. For the 1985 tax year and succeeding tax years, the taxpayers argue that the application of sec. 7872 dictates only income, not gift, tax consequences for any deemed transfers of foregone interest.

Both parties agree that IRC sec. 7872 was not in effect for Wisconsin tax purposes for the tax years at issue prior to 1985.

The Commission concluded that, for all periods under review, deemed "transfers" of foregone interest in a corporation-to-shareholder loan setting must be viewed under the Wisconsin Statutes as distributions in respect of stock, producing either dividend income, basis reduction of shares held, or capital gain consequences to the distributee.

For deemed transfers of foregone interest taking place during and after 1985, the legislative history of IRC sec. 7872 explicitly prescribes that demand loans made from a closely held corporation to a controlling shareholder be treated as a distribution with respect to the stock of the distributing corporation and be taxed to the shareholder as a dividend to the extent of the corporation's earnings and profits.

Deemed transfers prior to 1985, must be viewed through the application of sec. 71.301(3)(b) and (c), Wis. Stats. (1981-82, 1983-84). Once a transfer is deemed to have taken place from corporation to shareholder, the language of sec. 71.301 requires dividend, basis reduction, and capital gain treatment consistent with any distribution made in respect to stock.

On September 3, 1993, the department filed a petition for rehearing of the Commission's ruling and order. The Commission concluded that no material error exists in its finding of fact or conclusions of law contained in its August 16, 1993, ruling and order.

The department has not appealed but has adopted a position of nonacquiescence in regard to this decision. □