

ownership percentage requirement for deducting dividends was reduced from 80% to 70% of the payer corporation's stock, and insurance companies may claim a dividends received deduction even if the payer corporation is not a Wisconsin corporation. The text of Tax 3.03 is as follows:

**Tax 3.03 DIVIDENDS RECEIVED DEDUCTION — CORPORATIONS.** (ss. 71.22(4), 71.26(2) and (3)(j), 71.42(2) and 71.45(2)(a)8, Stats.) (1) **PURPOSE.** This section clarifies the deduction from gross income allowed to

corporations for dividends received. Dividends may be deductible due to the recipient's ownership of the payer corporation, as provided in sub. (3).

(2) **DEFINITION.** "Dividends received" means gross dividends minus taxes on those dividends paid to a foreign nation and claimed as a deduction under ch. 71, Stats.

(3) **DIVIDENDS DEDUCTIBLE DUE TO OWNERSHIP.** A corporation may deduct from gross income 100% of the dividends received from a payer corporation during a taxable year if both of the following occur:

(a) The dividends are paid on common stock of the payer corporation.

(b) The corporation receiving the dividends owns directly or indirectly during the entire taxable year in which the dividends are received at least 70% of the total combined voting stock of the payer corporation.

(4) **LIMITATION ON DEDUCTION.** The deduction under sub. (3) may not exceed the dividend received and included in gross income for a taxable year.

(5) **DIVIDENDS INCLUDABLE IN GROSS INCOME.** All dividend income shall be included in full in gross income on the franchise or income tax return of the recipient, whether or not certain dividends are deductible. □



## 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

**— Basis of assets — gifts — basis for gain or loss.** *Patrick J. and Jo Ann Murphy, Jr., and Patrick and Carrie Murphy, III vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, September 14, 1995). The issue in this case is whether the department erred in assessing the taxpayers for additional income tax and interest on the gain realized as a result of their March 7, 1989 sale of real property held by them, where interests in that property were previously transferred to Jo Ann Murphy and Patrick J. Murphy, III as a gift from Patrick J. Murphy, Jr. at a time when his basis in the property was \$26,500, and the fair market value of the property was \$167,000.

On January 27, 1989, taxpayer Patrick J. Murphy, Jr. conveyed by quit claim deed partial interests totalling 75% of the ownership of certain real property, which was previously solely owned by him. The grantees included his spouse, taxpayer Jo Ann M. Murphy, and four of his children,

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including his son, taxpayer Patrick J. Murphy, III. Patrick J. Murphy, Jr.'s basis in the property was \$26,500 on the date he conveyed it, and the property had an approximate fair market value of \$167,000 at the time.

Following the January 1989 conveyance, the same parcel of property was sold to a third party for \$167,000 on March 7, 1989. The sales price was paid on an installment basis during the years 1989, 1990, and 1991.

In June 1993, the department issued two separate Notices of Amount Due to the taxpayers as married couples who had filed income tax returns jointly during the period under review. In each circumstance, the department assessed additional tax and interest due as a result of the couples' alleged failure to properly report the annual gain realized from installment payments received with respect to the March 7, 1989 property sale.

The Commission concluded that the taxpayers failed to demonstrate by clear evidence that the department erred in assessing additional amounts of income tax and interest due on the gain realized as a result of the taxpayers' March 7, 1989 sale of real property to a third party. The gain realized on the sale is properly determined under Internal Revenue Code (IRC) sec. 1001 as the excess of sales price over donor basis under IRC sec. 1015, as applicable to determining Wisconsin taxable income for each of the years under review under sec. 71.01(6)(d) to (f), Wis. Stats. (1991-92).

Under IRC secs. 1001 and 1015 at all times during the period under review, realized gain on the disposition of appreciated property was equal to the sales price received less the applicable basis in the hands of the seller. For donees disposing of property, the basis of appreciated property is the

same as it would be in the hands of the donor before the time of the gift.

All four of the taxpayers have appealed this decision to the Circuit Court.

**CAUTION:** The decision with respect to taxpayers Patrick and Carrie Murphy III is a small claims decision of the Wisconsin Tax Appeals Commission and may not be used as a precedent. This decision is provided for informational purposes only. □

— **Farm loss limitation.** *David G. and Patricia Stauffacher vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, August 31, 1995). The only issue involved in this decision is whether the taxpayers were, during 1987 to 1991 (the period under review), engaged in "farming" within the meaning of Internal Revenue Code (IRC) sec. 464(e)(1), thereby subjecting them to the farming business loss limitations of sec. 71.05(6)(a)10, Wis. Stats.

Taxpayer David Stauffacher was the principal general partner of Golden Forest Limited Partnership ("Golden Forest"), a business venture which attempted to produce and market Shiitake mushrooms for profit. Some of the activities undertaken by Golden Forest at considerable expense may arguably be characterized as "research" or "manufacturing." However, those activities were undertaken pursuant to and in conjunction with the business venture, the production and marketing of Shiitake mushrooms for profit.

Golden Forest never became an economically viable business venture. The enterprise encountered various problems which prevented it from being profitable and ceased doing business in 1990.

The Commission concluded that the taxpayers were engaged in farming within the meaning of IRC sec. 464(e)(1), thereby subjecting them to the farming business loss limitations contained in sec. 71.05(6)(a)10, Wis. Stats. Even though there were elements of research and manufacturing involved in the Golden Forest operation, it was primarily a Shiitake mushroom production and marketing venture, entered into for profit, which must be considered "farming" by reasons of Rev. Rul. 75-484. The Commission will schedule further proceedings to resolve issues remaining between the parties.

The taxpayers have appealed this decision to the Circuit Court. □

— **Retirement funds exempt — constitutionality.** *John D. and Jane A. Hennick vs. Wisconsin Department of Revenue* (Circuit Court for Milwaukee County, September 26, 1995). The taxpayers appeal a decision of the Wisconsin Tax Appeals Commission (Commission), denying their claim for an income tax refund for taxes paid on private pension income. See *Wisconsin Tax Bulletin 91* (April 1995), page 13, for a summary of the Commission decision.

This is the third challenge brought by the taxpayers to the state of Wisconsin taxation of Mr. Hennick's pension. The issues in all three challenges are almost identical except for the years at issue and an amendment to sec. 71.05(1)(a), Wis. Stats., exempting certain pensions from taxation. The taxpayers challenge the constitutionality of the statute.

Mr. Hennick, employed from 1956 through 1983 by a private entity, receives annual pension payments pursuant to his service with his former employer. In June 1993, the taxpayers jointly filed amended Wis-

consin income tax returns for 1989 through 1992, excluding the annual pension payments.

The department denied the claim for refund, and the taxpayers filed a petition for redetermination, which the department denied. The taxpayers filed a petition for review with the Commission. The Commission determined that sec. 71.05(1)(a), Wis. Stats. (1989-90, 1991-92), does not violate either the Uniformity Clause in Article VIII of the Wisconsin Constitution or the Equal Protection Clause of the United States Constitution.

The taxpayers ask the Circuit Court to render sec. 71.05(1)(a), Wis. Stats., unconstitutional, maintaining that the statute violates the Fourteenth Amendment Equal Protection Clause of the United States Constitution and the Equal Protection and Uniformity Clauses of the Wisconsin Constitution.

The Circuit Court concluded that the Commission acted within its jurisdiction, according to law, had a rational basis for its decision, and its decision was supported by substantial evidence in the record. The department was not compelled to grant the taxpayers a refund for taxes paid on Mr. Hennick's pension.

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

#### INDIVIDUAL INCOME TAXES AND FARMLAND PRESERVATION CREDIT

← **Tax Appeals Commission — summary judgment.** *John R. and Gwendolyn Haugen vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, September 20, 1995). This is a ruling and order awarding summary judgment. There

is no genuine issue of material fact in this case.

During 1990, the taxpayers jointly filed a 1989 Wisconsin income tax return. Included in income was a gain on sales of certain farm animals and farm equipment, as reported on federal Schedule 4797. This resulted in a Wisconsin subtraction modification of \$21,020.

In November 1990, the taxpayers filed an amended 1989 Wisconsin income tax return, in which they claimed a farmland preservation credit of \$350, with the explanation "Taxpayer is filing for Farmland Preservation under prior year law. Real estate taxes not paid. Agreement dated 10-5-82."

In May 1991, they filed a second amended 1989 Wisconsin income tax return, in which the gain from the 1989 sale of the farm animals and farm equipment was removed from income. The explanation was that the gain was not reportable under sec. 108 of the Internal Revenue Code (IRC), which relates to certain exclusions of income from the discharge of indebtedness. The second amended return also reasserted the \$350 claim for farmland preservation credit.

In February 1992, the department disallowed the subtraction modification made in the second amended return, relating to the 1989 sales of farm animals and equipment. The department also adjusted the 1989 income to reflect a recognizable portion of gain realized on the proceeds from a foreclosure sale of mortgaged property. Lastly, the farmland preservation credit claim was disallowed because no certification was ever provided that the prior year's real estate taxes were paid. The taxpayers filed a petition for redetermination with the department, which was denied.

The foreclosure sale for which the department allocated recognizable gain to the taxpayers for 1989 in fact took place on November 20, 1990, as shown by a 1990 Form 1099-A issued by the lender, noting gross sale proceeds in the amount of \$89,847.41.

The facts do not show the presence of any discharge of indebtedness income relating to 1989 which would qualify under sec. 108, IRC.

The taxpayers have admitted that they did not pay 1988 real estate taxes, as required under sec. 71.59(1)(b), Wis. Stats. (1989-90). If it was the intent of the taxpayers to file for a farmland preservation credit under the prior year's law method, they would nonetheless be ineligible for the credit due to their claimed level of household income under sec. 71.09(11)(b)1, Wis. Stats. (1981-82), and the facts do not indicate eligibility for the minimum credit under sec. 71.09(11)(bm), Wis. Stats. (1981-82).

In December 1994, the department issued a separate assessment for 1990, in which it added the gain on the 1990 foreclosure sale of real estate. The time within which the taxpayers could have petitioned for redetermination of this separate assessment expired on February 20, 1995, rendering it final and conclusive under sec. 71.88, Wis. Stats. In a letter submitted to the Commission by the taxpayers' attorney, they requested that the 1990 assessment be consolidated with this action for review before the Commission and asked that the Commission reprimand the department's attorney for alleged ethical violations in the course of the issuance of the separate assessment for 1990 against the taxpayers.

The Commission held that it could not review the conclusive 1990 assessment on the foreclosure sale gain due to its lack of subject matter jurisdiction over the department's action,

there being no redetermination for the Commission to review. Further, the Commission has no jurisdiction to review alleged violations of the Rules of Professional Conduct for Attorneys. In addition, the Commission ordered as follows:

1. The taxpayers are awarded summary judgment with respect to department's 1989 assessment for gain on the foreclosure sale of real estate, since the sale took place in 1990.
2. The department is awarded summary judgment with respect to its assessment pertaining to the taxpayers' discharge of indebtedness income and eligibility for the farmland preservation credit for 1989.
3. The department's action on the taxpayers' petition for redetermination is affirmed, as modified by the removal of the 1989 foreclosure sale gain.

Neither the department nor the taxpayers have appealed this order.

## CORPORATION FRANCHISE AND INCOME TAXES

**← Apportionment — air carriers — interstate.** *United Parcel Service Co. vs. Wisconsin Department of Revenue* (Circuit Court for Dane County, July 26, 1995). This is a proceeding for judicial review of an August 30, 1994, decision of the Wisconsin Tax Appeals Commission, which affirmed a franchise tax determination made by the Wisconsin Department of Revenue against United Parcel Service Co. (UPSCO). The main issue in this case is whether the department's use of an unweighted arrivals and departures factor in the Rule Tax 2.46 apportionment formula violates the Due Process and Commerce Clauses of the United States Constitution. See *Wisconsin Tax Bulletin* 90 (January 1995), page 20, for a summary of the Commission's decision.

UPSCO is an air carrier, which, together with its affiliated corporations, provides a national and international air transportation service for small packages. UPSCO offers service throughout the United States and in certain other parts of the world, using seven different types of aircraft. During 1985 and 1986, the years at issue, UPSCO used its smallest aircraft — the Fairfield Expediter — almost exclusively for Wisconsin flights. That aircraft has a maximum payload of 4,450 pounds. In contrast, the next largest aircraft used by UPSCO during that time, a Boeing 727-100, has a maximum payload of 45,830 pounds. Although Expeditors represented only 21% of UPSCO's flights overall in those years, they accounted for 89-92% of flights arriving or departing Wisconsin.

As an air carrier, UPSCO is a "public utility" for purposes of the Wisconsin franchise tax. Wisconsin Administrative Code sec. Tax 2.46 provides a three-factor formula for apportioning the net business income of air carriers as

required by statute, consisting of (1) the ratio of aircraft arrivals and departures within the state to total aircraft arrivals and departures; (2) the ratio of revenue tons handled in the state to total revenue tons; and (3) the ratio of originating revenue within the state to total revenue.

In preparing its 1985 and 1986 tax returns, UPSCO calculated the arrivals and departures factors in those years using the takeoff and landing weight of arriving and departing aircraft rather than the raw number of such aircraft. This was done to account for the much more frequent use of small aircraft in Wisconsin. The result was arrivals and departures factors for the years 1985 and 1986 as follows:

	1985	1986
Wisconsin takeoff & landing weight	18,784,664	32,002,297
Total takeoff & landing weight	2,655,347,050	3,918,079,971
Ratio	0.707789%	0.816660%

In the audit of UPSCO, the department deleted takeoff and landing weight from the computation of the arrivals and departures factors and calculated the factor based on the raw number of arriving and departing flights. Thus, the department's ratio for 1985 was 6.167805%, based on 94,896 total flights, 5,853 of which were Wisconsin flights. This method produced a ratio of 4.437488% for 1986, because of 122,344 total flights, 5,429 were Wisconsin arrivals and departures.

The difference in the ratios used by the department and by UPSCO produced the following result in tax calculations for UPSCO's income apportioned to Wisconsin for 1985 and 1986: