The taxpayer held a general aviation fuel license pursuant to sec. 78.56, Wis. Stats. (1989-90). It was required to hold but did not hold a special fuel license pursuant to sec. 78.47, Wis. Stats. (1989-90). Although the department requested "numerous times" that the taxpayer file the special fuel tax reports required by sec. 78.49, Wis. Stats., the taxpayer did not do so. It did make some payments on account of its special fuel tax liability, but such payments are not at issue in this appeal.

In 1992, after receiving information from the Internal Revenue Service regarding fuel sales made by the taxpayer to customers in Wisconsin during the period under review, the department conducted a field audit to determine whether the fuel taxes due on such sales had been correctly reported and paid. As a result of the audit, the department issued assessments for special fuel tax and for general aviation fuel tax, both assessments including negligence penalties and interest.

The taxpayer was represented by its president, Terry L. Jones, at the hearing; he was the only witness who testified on behalf of the taxpayer. Although the taxpayer has objected to the assessments on various grounds, including non-delivery of fuel into motor vehicle tanks (special fuel), estoppel (special fuel), and statute of limitations (special and aviation fuels), no evidence or exhibits in support of its position were presented, other than Mr. Jones' testimony, which included the following statement: "My entire defense is on the basis of these [assessments] exceeding the statute [of limitations]."

The Commission concluded that the assessments by the department were proper and were not barred by any statute of limitations. Because the taxpayer offered no evidence at the hearing except the testimony of its president, it failed to meet the burden of proof set forth in sec. 78.70(4), Wis. Stats., which states that "the burden of proof shall be upon the licensee to show that the assessment was incorrect and contrary to law." The taxpayer's statute of limitations argument is grounded in sec. 78.66, Wis. Stats., which, the taxpayer claims, imposes a 3-year limitation on the assessments under review. However, sec. 78.66, Wis. Stats., is a record keeping requirement, not a limitation on assessments. Therefore, the taxpayer's position is without basis in fact or law.

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

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. Adjustments to the Self-Employment Tax Deduction (p. 23)
2. Medical Care Insurance Deduction for Shareholders of S Corporations (p. 23)

Corporation Franchise and Income Taxes

3. Tax-Option (S) Corporation's Treatment of Certain Exempt Bond Interest (p. 24)
4. Wisconsin Corporation Tax Treatment of Dividends Received From a Real Estate Investment Trust (REIT) (p. 25)

Sales and Use Taxes

5. Stadium Tax — "Engaged in Business" in the Special District (p. 26)

Withholding of Taxes

6. Withholding on Director's Fees and Payments to Corporate Officers (p. 27)

INDIVIDUAL INCOME TAXES

1 Adjustments to the Self-Employment Tax Deduction

Statutes: Section 71.01(6), Wis. Stats. (1993-94)

Background: Section 1401 of the Internal Revenue Code (IRC) imposes a tax on the self-employment income of individuals. For purposes of computing federal adjusted gross income, sec. 164(f), IRC, allows the individual to claim a deduction for one-half of the self-employment tax imposed by sec. 1401 for the taxable year.

Wisconsin generally follows the Internal Revenue Code in effect for the prior year when computing Wisconsin taxable income for a taxable year. For example, sec. 71.01(6)(i), Wis. Stats. (1993-94 as amended by 1995 Act 27), provides that for taxable years beginning in 1994, "Internal Revenue Code" means the federal Internal Revenue Code as amended to December 31, 1993, with certain exceptions.

Because Wisconsin follows the Internal Revenue Code, the federal deduction for one-half of the self-employment tax allowable in computing federal adjusted gross income also applies for Wisconsin.

Purpose of Tax Release: This tax release explains the effect that an adjustment to self-employment income on a Wisconsin individual income tax return has on the related adjustment for one-half of the federal self-employment tax.

If there is an adjustment on the Wisconsin individual income tax return which increases or decreases self-employment income and that adjustment affects the amount of federal self-employment tax, the related deduction on the Wisconsin return for one-half of federal self-employment tax should also be adjusted. (**Note:** The deduction for one-half of the federal self-employment tax should be adjusted regardless of the fact that the federal return may not be subsequently amended because of the 3-year statute of limitations. The deduction for one-half of the self-employment tax is based on the self-employment tax imposed on the income, not on the amount paid.)

Example 1: Taxpayer A files his 1992 federal and Wisconsin income tax returns timely. Under federal law, the taxpayer has until April 15, 1996, to amend his 1992 federal income tax return. Under Wisconsin law, the taxpayer has until April 15, 1997, to amend his 1992 Wisconsin income tax return.

In July of 1996, Taxpayer A discovers that he underreported his 1992 self-employment income by $2,000. The taxpayer will amend his 1992 Wisconsin return but cannot amend his 1992 federal return. The additional income would have resulted in additional federal self-employment tax of $282.

Taxpayer A should amend his 1992 Wisconsin income tax return to report the additional $2,000 of self-employment income and to claim a deduction of $141 for one-half of the federal self-employment tax imposed on the $2,000 of additional self-employment income.

Example 2: During an audit of Taxpayer B's 1994 Wisconsin income tax return, it is discovered that Taxpayer B overreported her 1994 self-employment income by $5,000. The $5,000 decrease to self-employment income will also reduce the federal self-employment tax imposed by $706 and the related deduction for one-half of the self-employment tax by $353. The Department of Revenue will adjust the Wisconsin income tax return and issue a refund based on a decrease in Wisconsin taxable income of $4,647 ($5,000 decrease in self-employment income less the $353 adjustment to the deduction for one-half of self-employment tax).

(**Note:** Although not illustrated in these examples, other items on the return may also be affected when self-employment income is adjusted. For example, the temporary recycling surcharge, earned income credit, homestead credit, farmland preservation credit, and taxable unemployment compensation may need to be adjusted when changes are made to self-employment income.) □

2 Medical Care Insurance Deduction for Shareholders of S Corporations

Statutes: Sections 71.01(5) and 71.05(6)(b)19 and 20, Wis. Stats. (1993-94)

Wis. Adm. Code: Section Tax 1.06, June 1990 Register

Note: This tax release applies only with respect to taxable years beginning on or after January 1, 1995.

Background: Section 71.05(6)(b)19 and 20, Wis. Stats. (1993-94), provides a deduction for medical care insurance costs paid by certain persons. A self-employed person is allowed a deduction for 100% of medical care insurance costs paid by the person. For a person who is an employe whose employer does not pay any amount toward the person's medical care insurance, a deduction is allowed for 50% of the medical care insurance costs paid by the person.

For federal tax purposes, self-employed persons are allowed a deduction from gross income for 30% of health insurance costs paid by the self-employed person (sec. 162(L), Internal Revenue Code). The federal self-employed health insurance deduction is allowable to a shareholder owning more than 2% of the outstanding stock of an S corporation.

Section 71.01(5), Wis. Stats. (1993-94), provides that terms not otherwise defined have the same meaning as in the Internal Revenue Code (IRC) unless the context requires otherwise.

Question: A shareholder owning more than 2% of the outstanding stock of an S corporation is allowed the federal self-employed health insurance deduction. Is the shareholder considered an employe (entitled to a 50% deduction) or a self-employed person (entitled to a 100% deduction) for purposes of claiming the Wisconsin medical care insurance deduction?

Answer: A shareholder owning more than 2% of the outstanding stock of an S corporation is considered a self-employed person for purposes of claiming the Wisconsin medical care insurance deduction. Because Wisconsin law does not define self-employed person, the federal meaning applies. Under sec. 162(L)(5), IRC, shareholders owning more than 2% of an S corporation's stock are considered self-employed for purposes of the federal self-employed health insurance deduction. These shareholders are also considered self-employed for the Wisconsin medical care insurance deduction.

Note: For further information on the medical care insurance deduction as it applies to shareholders of S corporations, see the tax release titled "Medical Care Insurance Deduction" in *Wisconsin Tax Bulletin* 88 (July 1994), page 20. □

CORPORATION FRANCHISE AND INCOME TAXES

3 Tax-Option (S) Corporation's Treatment of Certain Exempt Bond Interest

Statutes: Sections 71.34(1) and 71.36(1m), Wis. Stats. (1993-94), as amended by 1995 Wisconsin Acts 27 and 56

Wis. Adm. Code: Section Tax 3.095, January 1994 Register

Note: This tax release supersedes the tax release with the same title that was published in *Wisconsin Tax Bulletin* 91, (April 1995), page 20.

Background: For the 1987 taxable year and thereafter, Wisconsin treats tax-option (S) corporations as pass-through entities, the same as for federal purposes. Items of income, loss, and deduction retain their character as business income or loss but pass through to the shareholders and are included in the shareholders' returns as if received or accrued, paid or incurred, directly by the shareholders.

For taxable years beginning before January 1, 1995, a tax-option (S) corporation may deduct from its net income all amounts included in the Wisconsin adjusted gross income of its shareholders, the capital gain deduction under sec. 71.05(6)(b)9, Wis. Stats., and all amounts not taxable to nonresident shareholders under secs. 71.04(1) and (4) to (9) and 71.362, Wis. Stats. For purposes of the tax-option corporation deduction, interest on federal obligations is not included in shareholders' income. Section 71.36(1m), Wis. Stats. (1993-94).

For taxable years beginning on or after January 1, 1995, sec. 71.36(1m) was amended by 1995 Wisconsin Acts 27 and 56 to provide that a tax-option (S) corporation may deduct from its net income all amounts included in the Wisconsin adjusted gross income of its shareholders, the capital gain deduction under sec. 71.05(6)(b)9, Wis. Stats., and all amounts not taxable to nonresident shareholders under secs. 71.04(1) and (4) to (9) and 71.362, Wis. Stats. For purposes of the tax-option corporation deduction, interest on federal obligations, obligations issued under sec. 66.066, Wis. Stats., by a local professional baseball park district, obligations issued under secs. 66.40, 66.431, and 66.4325, Wis. Stats., obligations issued under sec. 234.65, Wis. Stats., to fund an economic development loan to finance construction, renovation, or development of property that would be exempt under sec. 70.11(36), Wis. Stats., and obligations issued under subchapter II of chapter 229, Wis. Stats., is not included in shareholders' income.

Question: A tax-option (S) corporation is subject to a Wisconsin franchise tax measured by what types of interest and dividend income?

Answer:

A. *Taxable years ending on or after July 31, 1987, and beginning before January 1, 1995*

For taxable years ending on or after July 31, 1987, and beginning before January 1, 1995, a tax-option (S) corporation is subject to Wisconsin franchise tax measured by the amount of interest and dividend income received from obligations of the United States government and its instrumentalities, which is allocable to Wisconsin.

A tax-option (S) corporation is not subject to franchise tax measured by interest income on certain bonds issued by the government of Puerto Rico, other U.S. territories and possessions, and state and local governments that is exempt from the Wisconsin individual income tax. See section Tax 3.095, Wis. Adm. Code, for a list of exempt securities.

B. *Taxable years beginning on or after January 1, 1995*

For taxable years beginning on or after January 1, 1995, a tax-option (S) corporation is subject to Wisconsin franchise tax measured by the following interest and dividend income, which is allocable to Wisconsin:

- Obligations issued by the United States government and its instrumentalities.
- Municipal housing authority bonds issued under sec. 66.40, Wis. Stats.
- Municipal redevelopment authority bonds issued under sec. 66.431, Wis. Stats.
- Housing and community development authority bonds issued under sec. 66.4325, Wis. Stats.
- Bonds issued by the Wisconsin Housing and Economic Development Authority (WHEDA) under sec. 234.65, Wis. Stats., to fund an economic development loan to finance construction, renovation, or development of property that would be exempt from property tax under sec. 70.11(36), Wis. Stats. (professional sports and entertainment home stadiums).
- Bonds issued by a local exposition district under subchapter II of chapter 229, Wis. Stats.
- Bonds issued by a local professional baseball park district created under subchapter III of chapter 229, Wis. Stats.

Interest income from bonds issued by the government of Puerto Rico and other U.S. territories and possessions that is exempt from the Wisconsin individual income tax continues to be excluded from a tax-option (S) corporation's net income for Wisconsin franchise tax purposes. □

4 Wisconsin Corporation Tax Treatment of Dividends Received From a Real Estate Investment Trust (REIT)

Statutes: Section 71.26(2) and (3)(j), Wis. Stats. (1993-94)

Background: For federal income tax purposes, a corporation, with certain exceptions, trust, or association that specializes in investments in real estate and real estate mortgages and meets certain ownership and income requirements may elect to be taxed as a real estate investment trust (REIT). A REIT that distributes at least 95% of its taxable income for the taxable year and complies with certain requirements is generally treated as a pass-through entity. The REIT receives a dividends-paid deduction for the distributions made to its beneficiaries, and the distributed earnings are taxed to the beneficiaries. As a result, a REIT is subject to federal tax only on certain retained earnings, net income from foreclosure property, net income from prohibited transactions, and income that fails to meet certain requirements. See Internal Revenue Code (IRC) section 857 for additional information.

Internal Revenue Code sec. 857(c) provides that a dividend received from a REIT is not considered a dividend for purposes of the deduction under IRC sec. 243 for dividends received by corporations. As a result, a corporation receiving REIT dividends is subject to federal income tax on those dividends.

For Wisconsin purposes, a REIT computes its income under the Internal Revenue Code, with certain limited exceptions, as provided in sec. 71.26(2)(b), Wis. Stats. (1993-94). Thus, a REIT is generally treated as a pass-through entity for Wisconsin, the same as for federal purposes.

A corporation computes its Wisconsin net income under the Internal Revenue Code, with certain modifications prescribed in sec. 71.26(3), Wis. Stats. (1993-94). Sec. 71.26(2)(a), Wis. Stats. (1993-94). One of those modifications is sec. 71.26(3)(j), which excludes IRC secs. 243, 244, 245, 246, and 246A and replaces them with the rule that corporations may deduct from income dividends received from a corporation with respect to its common stock if the corporation receiving the dividends owns, directly or indirectly, during the entire taxable year at least 70% of the total combined voting stock of the payor corporation. Section 71.26(3) does not modify IRC sec. 857 for Wisconsin purposes.

Question: Assuming a corporation owns at least 70% of the common stock of another corporation that qualifies as a REIT, may the corporation claim the dividends received deduction under sec. 71.26(3)(j), Wis. Stats. (1993-94), for the dividends received from the REIT?

Answer: No, the corporation may not claim the Wisconsin dividends received deduction for dividends received from a REIT. Under IRC sec. 857(c), REIT dividends are not considered dividends for purposes of

IRC sec. 243. Section 71.26(3)(j), Wis. Stats. (1993-94), substitutes a Wisconsin dividends received deduction for the federal deduction under IRC sec. 243. Since IRC sec. 857(c) is not excluded from the Internal Revenue Code for Wisconsin purposes, this code section applies for Wisconsin. Thus, a dividend received from a REIT is includable in the corporation's Wisconsin net income. □

SALES AND USE TAXES

Note: The following tax release interprets the Wisconsin sales and use tax law as it applies to the 0.1% stadium sales and use tax. For information on sales or purchases that are subject to the stadium sales and use tax, refer to the December 1995 issue of the *Sales and Use Tax Report*. A copy can be found in *Wisconsin Tax Bulletin* 95 (January 1996), pages 41 to 47.

5 Stadium Tax – "Engaged in Business" in the Special District

Statutes: Sections 77.51(13g) and 77.79, Wis. Stats. (1993-94), secs. 77.71(1) and 77.73(1), as amended by 1995 Wisconsin Act 56, and sec. 229.67, as created by 1995 Wisconsin Act 56.

Introduction: In November 1995, the Professional Baseball Park District was created for purposes of assisting in the development of a professional baseball park in Wisconsin. This district is referred to in the Wisconsin Statutes as a "special district." The special district includes the following five Wisconsin counties: Milwaukee, Ozaukee, Racine, Washington, and Waukesha.

Effective January 1, 1996, the special district began imposing a 0.1% sales and use tax on the sale of, and the storage, use, or consumption of tangible personal property or taxable services in the special district. This sales and use tax is referred to as the "stadium tax."

Question: For purposes of the stadium tax, does a retailer determine whether it is "engaged in business" (has nexus) in the special district on:

1. A special district basis (nexus in one or more of the five counties is nexus in the entire special district), or

2. A per county basis (nexus is determined separately for each of the five counties)?

Answer: A retailer determines whether it is "engaged in business" (has nexus) in the special district on a "special district basis." Therefore, a retailer "engaged in business" (having nexus) in one or more of the five counties comprising the special district (Milwaukee, Ozaukee, Racine, Washington, or Waukesha county) is "engaged in business in the special district." Accordingly, any sales that occur in the special district (i.e., any sales in Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties) are subject to the stadium tax if the retailer is "engaged in business" (has nexus) in one or more of the five special district counties.

Note: A sale of tangible personal property takes place where possession of the property transfers from the seller or the seller's agent to the buyer or the buyer's agent. The rental or lease of tangible personal property takes place where the property will be located with the following exceptions:

1. The rental of motor vehicles and other equipment used principally on the highway at normal highway speeds takes place where they will be customarily kept, except that the rental or lease of drive-it-yourself motor vehicles and equipment used principally on the highway at normal highway speeds and used for one-way trips or leased for less than one month takes place in the county where they come in to the lessee's possession.

2. The rental or lease of moving property, other than in 1. above, takes place in the county where it will be primarily used or is usually kept.

A sale of services takes place where the service is furnished except:

1. The sale of communication services, if the customer calls collect or pays by credit card, takes place where the customer is billed.

2. The sale of towing services takes place at the location where the vehicle is delivered.

3. The sale of services to tangible personal property takes place where the property serviced is delivered to the buyer.

Caution: The above answer does not apply to the sale of motor vehicles, boats, snowmobiles, mobile homes not exceeding 45 feet in length, trailers, semitrailers, all-terrain vehicles, or aircraft registered or titled or required to be registered or titled in this state. The retailer is subject to the stadium tax on sales of such items if the items will customarily be kept in the stadium district, regardless of whether the retailer is "engaged in business" in the special district.

The examples below illustrate the above answer.

Example 1: Company A has its business location in Waukesha County. Company A sells tangible personal property in Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties. The tangible personal property sold is shipped from Company A's Waukesha location by common carrier to the customers in those counties.

Company A is "engaged in business" (has nexus) in the special district because of its business location in Waukesha County.

Company A's sales in Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties are subject to the stadium tax because **both** of the following apply:

a. Company A is "engaged in business" (has nexus) in the special district.

b. The sales take place in the special district (Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties).

Example 2: Company B has its business location in Kenosha County. Company B delivers the tangible personal property it sells to customers in Milwaukee County using its own trucks. Company B also sells tangible personal property in Ozaukee, Racine, Washington, and Waukesha counties. The tangible personal property is delivered to the customer by U.S. Mail in these 4 counties.

Company B is "engaged in business" (has nexus) in the special district because it uses its own trucks to deliver its products into Milwaukee County.

Company B's sales in Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties are subject to the stadium tax because **both** of the following apply:

a. Company B is "engaged in business" (has nexus) in the special district.

b. The sales take place in the special district (Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties).

Example 3: Company C has its business location in Illinois. Company C also has a sales office in Milwaukee County. Company C sells tangible personal property in Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties. The tangible personal property is delivered to the customers by common carrier.

Company C is "engaged in business" (has nexus) in the special district because of its sales office located in Milwaukee County.

Company C's sales in Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties are subject to the stadium tax because **both** of the following apply:

a. Company C is "engaged in business" (has nexus) in the special district.

b. The sales take place in the special district (Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties).

Example 4: Company D has its business location in Kenosha County. Company D sells tangible personal property to customers in Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties. The tangible personal property is delivered to the customers by common carrier. Company D also originates leases at its Kenosha location. The tangible personal property leased is non-moving property that will be located in Milwaukee County.

Company D is "engaged in business" (has nexus) in the special district because of its lease of tangible personal property in Milwaukee County.

Company D's lease and sale of tangible personal property in Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties are subject to the stadium tax because **both** of the following apply:

a. Company D is "engaged in business" (has nexus) in the special district.

b. The sale and lease of tangible personal property takes place in the special district (Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties). □

WITHHOLDING OF TAXES

6 Withholding on Director's Fees and Payments to Corporate Officers

Statutes: Sections 71.63 and 71.64, Wis. Stats. (1993-94)

Background: Section 71.64, Wis. Stats. (1993-94), provides that an employer must withhold Wisconsin income tax from the wages paid to an employe.

"Employe" is defined in sec. 71.63(2), Wis. Stats. (1993-94), as a resident individual who performs services for an employer anywhere or a nonresident individual who performs services within Wisconsin. The term includes an officer of a

corporation. "Employer" is defined in sec. 71.63(3), Wis. Stats. (1993-94), as a person (including a corporation), partnership, or limited liability company for whom an individual performs services. "Wages" is defined in sec. 71.63(6), Wis. Stats. (1993-94), as all remuneration for services performed by an employe for an employer. Some exceptions apply to the definition of "wages."

Question: Is a corporation required to withhold Wisconsin income tax from director's fees and payments to corporate officers?

Answer: Fees a corporation pays to an individual for performing services as a director are not subject to Wisconsin withholding as there is no employer/employe relationship between the individual and the corporation.

Amounts paid to an officer of the corporation for services are subject to Wisconsin withholding. An officer of a corporation is an employe of the corporation under sec. 71.63, Wis. Stats. (1993-94), and Wisconsin withholding is required on payments for services.

Note: An individual may perform services both as a director and as an officer of the same corporation. Remuneration paid to the individual for services performed in his or her capacity as a director of the corporation is not subject to Wisconsin withholding. Remuneration paid to the individual which is attributable to his or her duties solely as an officer of the corporation constitutes "wages" subject to Wisconsin withholding. □