The taxpayer, a Wisconsin corporation, is a utility in the business of producing, distributing, and selling electric power and distributing natural gas in Wisconsin.

In 1982, the taxpayer, as buyer/lessor, purchased and leased certain property under Internal Revenue Code (IRC) sec. 168(f)(8) for the purpose of (1) acquiring from the seller/lessee the federal income tax benefits related to the property, (2) acquiring the Wisconsin franchise tax benefits at issue in this proceeding, and (3) permitting the taxpayer's parent corporation, which files a unitary Minnesota return that includes the taxpayer, to acquire certain Minnesota tax benefits.

With regard to these transactions, the taxpayer paid $13,782,811 in cash to a number of unrelated corporations and paid $262,886 for transactional costs, such as legal fees, for a total 1982 expenditure of $14,045,697. In the course of these transactions, the taxpayer entered into 13 safe harbor leases, 8 of which had a 15-year term. The remaining safe harbor leases were of shorter and longer terms, the longest term being 22.5 years. The cost of the equipment covered by the safe harbor leases was about $50 million.

For purposes of this proceeding, the taxpayer's safe harbor lease with General Dynamics Corporation is representative, in all material respects, of all 13 safe harbor leases. The General Dynamics transaction consisted of the following steps, all of which General Dynamics and the taxpayer agreed were undertaken "for income tax purposes only":

a. General Dynamics sold to the taxpayer certain items of equipment, for a total purchase price of $2,495,114. The taxpayer paid $736,058.63 to General Dynamics at closing on December 30, 1982, and the balance of the purchase price was the taxpayer's purchase money obligation payable to General Dynamics in 60 equal quarterly installment payments commencing March 29, 1983, with an annual interest rate of 22.999%.

b. The taxpayer also incurred in 1982 $17,045.78 in transactional costs, such as legal fees, in connection with the General Dynamics transaction.

c. The taxpayer immediately leased the items of equipment back to General Dynamics for a lease term of 15 years. General Dynamics agreed to pay annual rent of $419,209.50 to the taxpayer in equal quarterly installments commencing March 29, 1983.

d. General Dynamics and the taxpayer understood and agreed that the taxpayer's payments on its purchase money obligation and General Dynamics' rent payments would be (1) equal to each other in timing and amount, (2) contingent on each other, and (3) made by offset so that no actual cash would trade hands after the closing. As of May 18, 1995, all payments/offsets have been made as scheduled.

The federal tax consequences to the taxpayer of the General Dynamics transaction were:

a. For its 1982 taxable year, the taxpayer claimed an investment tax credit against its federal income tax liability equal to 10% of the cost of the equipment under IRC sec. 38.

b. Commencing with its 1982 taxable year, the taxpayer depreciated the cost of the equipment as 5-year property under IRC sec. 168.

c. Commencing with its 1983 taxable year, the taxpayer deducted the interest accrued on its purchase money obligation to General Dynamics.

d. Commencing with its 1983 taxable year, the taxpayer included in its income rentals accrued from General Dynamics.

e. Commencing with its 1983 taxable year, the taxpayer amortized its transactional costs ratably over the lease term. Because the General Dynamics transaction occurred so late in 1982, the amortization of the transactional expenses properly began in 1983. In other transactions that closed earlier in 1982, the transactional expense amortization began in 1982.

In February of 1983, the taxpayer calculated the projected cost and tax benefits to the taxpayer of entering into all 13 safe harbor leases from 1982 through 2005, the year in which the last safe harbor lease will expire. The taxpayer will be able to realize federal tax benefits in each year of each lease, although in some years, the tax benefits will be outweighed by certain tax costs as a result of entering into the lease. The taxpayer expected to benefit from the 13 safe harbor leases because they would have the effect of generating positive cash flow for approximately 11 years and, thereby, reducing its interest expenses and increasing its income.

For 1982, Wisconsin's franchise tax law incorporated Internal Revenue Code provisions relating to depreciation and amortization of depreciable property, except IRC sec. 168(f)(8), the section recognizing safe harbor leases. By failing to incorporate IRC sec. 168(f)(8), the Wisconsin law does not consider the 13 safe harbor leases to be actual sales and leasebacks, and each seller/lessee remained the true owner of the equipment at all times. Accordingly, the taxpayer did not claim any depreciation expenses, report any rental income, or claim any interest expenses for Wisconsin franchise tax purposes.

The taxpayer did, however, for Wisconsin franchise tax purposes, claim a deduction for the amortization of its out-of-pocket costs associated with the safe harbor leases, including the payments to sellers/lessees and transaction costs. In each case, the taxpayer's costs were amortized over the term of the lease involved. On its 1982 franchise tax return, the taxpayer claimed $212,762 for the amortization of its investment in the 13 safe harbor leases.

Under the date of January 29, 1985, the department issued a notice of franchise tax assessment against the taxpayer for taxable years 1979 to 1982 for additional tax and interest in the approximate amount of $4 million. In the assessment, the department disallowed, among other things, $209,242 of the $212,762 the taxpayer claimed in its taxable year 1982 for the amortization of the taxpayer's investment in the safe harbor leases. The department allowed $3,520 of the $212,762 the taxpayer claimed, representing the amortization of the taxpayer's legal fees the taxpayer incurred with regard to the 13 safe harbor leases.

The Commission found that while the Wisconsin franchise tax law excluded IRC sec. 168(f)(8), it incorporated IRC sec. 167 for taxable years after 1972. Sec. 71.04(15)(a), Wis. Stats. (1981-82). Internal Revenue Service (IRS) regulations under IRC sec. 167 are incorporated into Wisconsin's Administrative Code in sec. Tax 1.06. Regulation 1.167(a)-3 permits a taxpayer to amortize the cost of an intangible asset if the asset is known from experience or other factors to be of use in the business or in the production of income for only a limited time and this time can be estimated with reasonable accuracy.

Therefore, the Commission concluded that the taxpayer's tax benefits were intangible assets useful to the taxpayer's business and useful in the production of income under IRS Regulation 1.167(a)-3. The taxpayer is entitled to deduct the amounts it paid to each seller/lessee for tax benefits, amortized over the term of the safe harbor lease, under IRC sec. 167 as incorporated into Wisconsin's franchise tax law.

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

SALES AND USE TAXES

Assessments – statute of limitations; Leases and rentals – property affixed to realty; Interest – 18% delinquent rate; Penalties – negligence – failure to file. *Aqua Finance, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, February 26, 1996). The issues in this case are:

A. Whether the department is barred from assessing sales tax because its notice of action was arguably untimely.

B. Whether the taxpayer is liable for sales tax on its sale or lease of water treatment equipment.

C. Whether the taxpayer is liable for delinquent filing fees and interest.

D. Whether the taxpayer is liable for a 25% penalty for failing to file a return in the absence of reasonable cause.

The taxpayer is a Wisconsin corporation, engaged in the business of leasing and selling water treatment equipment. The taxpayer had master agreements with a number of water treatment equipment dealers ("dealers") that provided for the sale from the dealers to the taxpayer of water treatment equipment after the dealers installed the equipment in the property of dealers' customers ("customers").

The following procedures were used by the taxpayer and its dealers:

1. The dealer installed water treatment equipment from its inventory into the property of the customer;

2. At the time of installation, the customer signed a lease agreement, on forms drafted by the taxpayer, to rent the equipment from the taxpayer;

3. The dealer then collected the first and last month's rent from the customer;

4. The taxpayer then paid the dealer for the water treatment equipment in accordance with the terms of the dealer's master agreement with the taxpayer;

5. The taxpayer then collected the remaining payments from the customer under the lease agreement;

6. UCC financing statements were filed with the register of deeds to secure the taxpayer's security interest in the water treatment equipment.

Customers had the option under lease agreements to purchase the water treatment equipment from the taxpayer for a price established in the lease agreements.

If, at the end of the lease term, a customer did not exercise the option to purchase the water treatment equipment, the dealer involved was obligated to purchase the equipment from the taxpayer for a price in accordance with the lease agreement. If a customer defaulted, the dealer involved was obligated to assist in collection activity, and, if the default lasted 91 days, the dealer would be obligated under the master agreement, at the taxpayer's option, to repurchase the equipment and purchase the lease agreement from the taxpayer.

The lease agreements authorized the taxpayer to remove water treatment equipment in the event of termination of the lease agreement or breach of the lease agreement by customers. The lease agreements provided that the water treatment equipment continued to be the taxpayer's property (unless the customer exercised the option to purchase) and continued to be personal property, notwithstanding the fact that the equipment may be affixed to real property.

The taxpayer considered itself to be the owner of the water treatment equipment, and the taxpayer claimed depreciation expenses with regard to the equipment on its franchise tax returns. The taxpayer did not install any of the water treatment equipment. Water treatment equipment was serviced by dealers.

Mr. Robert D. Chadwell is president, chief financial officer, and founder of the taxpayer. Mr. Chadwell's prior experience includes (1) chief operating officer and 25% owner of Marathon Harvestore, Inc., (2) senior vice-president and senior loan officer for the State Bank of Medford, (3) branch manager and agricultural loan officer for the First National Bank in Appleton, and (4) branch manager of Associates Financial Services in Appleton.

At the time the taxpayer commenced leasing water treatment equipment, Mr. Chadwell and the taxpayer's tax accountant discussed the potential sales tax liability on such receipts and concluded that the transactions involved real property and, therefore, were not subject to the sales tax.

On July 29, 1992, the department issued a notice of assessment to the taxpayer for sales and use taxes due for the period of October 1, 1988 through September 30, 1991. On September 17, 1992, the taxpayer filed a petition for redetermination with the department.

The department's notice of action affirming in part and denying in part the petition for redetermination was mailed on September 15, 1994 and received by the taxpayer's president on September 16, 1994.

The Commission concluded as follows:

A. The department issued its notice of action in a timely manner consistent with sec. 77.59(6)(a), Wis. Stats. The deadline for the department to issue its notice of action, as provided in a stipulation, was extended to September 16, 1994.

B. The taxpayer is liable for sales tax on its gross receipts from the lease and sale of water treatment equipment. The taxpayer is a retailer as that term is defined in sec. 77.51(13), Wis. Stats., because it sold tangible personal property and it derived rentals from the lease of tangible personal property.

   The taxpayer's sales and leases of water treatment equipment were made at retail. Until it is sold to customers or dealers, water treatment equipment installed in a customer's home retains its character as tangible personal property pursuant to sec. 77.51(20), Wis. Stats.

C. The taxpayer is liable for delinquent filing fees and interest at 1.5% per month from the due date of its sales tax returns pursuant to sec. 77.60(2)(b), Wis. Stats., because the taxpayer failed to file sales tax returns even though they were required.

D. The taxpayer is liable for a penalty of 25% of the principal tax assessment for failing to file a return in the absence of reasonable cause under sec. 77.60(4), Wis. Stats.

The taxpayer has not appealed this decision. ☐

Exemptions – common or contract carrier vehicles. *Millard Feed Mill, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, March 18, 1996). The issues in this case are:

A. Whether the taxpayer was a common or contract carrier within the meaning of sec. 77.54(5)(b), Wis. Stats., during the period under review.

B. Whether the taxpayer used the truck tractors and semitrailers it purchased exclusively as a common or contract carrier within the meaning of sec. 77.54(5)(b), Wis. Stats., during the period under review.

During the period from October 1, 1987 through September 30, 1991 ("the period under review"), the taxpayer was a Wisconsin corporation engaged in the business of buying and selling feed, fertilizer and chemicals, grain, and various other products, and commercial over-the-road trucking.

The taxpayer had four departments. The taxpayer's feed department purchased feed products at wholesale and sold them to the general public, at times blending individual feeds to produce formulated blends for resale. The taxpayer's fertilizer and chemicals department purchased fertilizers and chemicals at wholesale and sold them to the general public, at times also producing formulated blends for resale. The fertilizer department also applied fertilizer to farmers' fields.

The taxpayer's grain department purchased corn and small grains from farmers, dried and stored grain, and sold corn and grain to grain terminals. The taxpayer's trucking department hauled bulk materials for other departments of the taxpayer and for third parties. The taxpayer held licenses with either the federal or state transportation authorities, or both, with respect to its hauling vehicles and carriage activities.

The taxpayer's financial statements indicate that its investment in autos and trucks, some of which were used in the trucking department's hauling activity, totalled no more than 15% of the taxpayer's total investment in fixed assets for any year during the period under review. During the same period of time, the taxpayer's inventory for sale constituted about 33% of the taxpayer's total assets.

Approximately 5% of the taxpayer's total sales were attributable to the trucking department, which included interdepartmental billing for hauling services performed by the trucking department for the taxpayer's other departments. Approximately 66% of the 1990 sales of the trucking department consisted of hauling services provided to the taxpayer's other departments.

The Commission concluded:

A. The taxpayer was not a contract carrier within the meaning of sec. 77.54(5)(b), Wis. Stats., during the period under review, because the taxpayer's primary business was something other than transportation services.

B. The taxpayer did not use the truck tractors and semitrailers it purchased exclusively in contract carriage within the meaning of sec. 77.54(5)(b), Wis. Stats., during the period under review, because private use of the vehicles by the taxpayer in furtherance of its own business activities far exceeded contract carriage for third parties, let alone any standard of de minimis or "infrequent or sporadic" usage allowable under sec. Tax 11.16(am), Wis. Adm. Code.

The taxpayer has not appealed this decision. □

Leases and rentals – personal use of auto by employe. *Skyline Development Corp. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, February 13, 1996). The issue in this case is whether the arrangement between the taxpayer and its employes for the reimbursement for personal use of the taxpayer's vehicles constitutes the rental of tangible personal property subject to sales tax.

The taxpayer is a corporation, engaged in the business of building industrial and commercial buildings in Wisconsin. The taxpayer is not in the business of leasing or renting tangible personal property, including motor vehicles, to others.

The taxpayer's corporate vehicles were used by the taxpayer's employes in carrying out their duties supervising and organizing the taxpayer's construction projects. This use was a necessary and proper part of the taxpayer's business. In addition, each of the corporate vehicles were used by the taxpayer's employes for personal use. The degree of personal use of corporate vehicles varied, but none of the vehicles were used exclusively for an employe's personal use.

The taxpayer required each employe possessing a corporate vehicle to regularly report the number of miles the vehicle was used for business purposes and the number of miles the vehicle was used for personal use. The employe paid the taxpayer for personal use using a reimbursement formula based on the taxpayer's costs for that vehicle. The requirement to report and pay for personal use of vehicles was not in writing.

The taxpayer did not mark up or make a "profit" on the payments received from employes for the personal use of corporate vehicles. Payment for personal use of the vehicles was accomplished by deducting the appropriate amount from the paycheck of each employe possessing a corporate vehicle.

The department's auditors routinely and consistently make sales tax adjustments for payments received by businesses for employes' personal use of company automobiles.

The Commission concluded that the taxpayer is liable for sales tax on its receipts from employes for the use of corporate vehicles. The taxpayer is a retailer as that term is defined in sec. 77.51(13), Wis. Stats., because it is a person deriving rentals from the lease of tangible personal property. The amounts received by the taxpayer from employes as reimbursement for their personal use of the taxpayer's corporate vehicles are gross receipts as that term is defined in sec. 77.51(4)(a), Wis. Stats.

The arrangement between the taxpayer and its employes for the use and reimbursement for their personal use of the taxpayer's vehicles constitutes the rental of tangible personal property at retail to the taxpayer's employes. The rental of the taxpayer's corporate vehicles to its employes for their personal use is not an occasional sale as that term is defined in sec. 77.51(9), Wis. Stats., because the rental of the corporate vehicles was neither isolated nor sporadic.

The taxpayer has not appealed this decision. □

Rebates; Sovereign immunity. *John Grall, et al. vs. Mark Bugher, Secretary of the Wisconsin Department of Revenue, et al.* (Circuit Court for Dane County, January 30, 1996). This case was remanded to the Circuit Court by the Wisconsin Supreme Court. The dispositive issue in this case is whether the department is immune from suit.

A summary of the Court of Appeals December 16, 1993 decision is contained in *Wisconsin Tax Bulletin* 90 (January 1995), page 24. The taxpayers appealed the Court of Appeals decision to the Wisconsin Supreme Court, which, on May 23, 1995, reversed the Court of Appeals decision and remanded the case to the Circuit Court.

The Circuit Court dismissed the matter, since the taxpayers have indicated that they wish to pursue their administrative remedies prior to pursuing any further action in the Circuit Court. Neither the taxpayer nor the department appealed the Circuit Court dismissal. □

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: