

## Chapter Tax 3

INCOME TAXATION, DEDUCTIONS FROM GROSS  
INCOME, EXCLUSIONS AND EXEMPTIONS

Tax 3.03	Dividends received deduction-corporations (p. 79)	Tax 3.096	Interest paid on money borrowed to purchase exempt government securities (p. 86)
Tax 3.085	Retirement plan distributions (p. 80)	Tax 3.098	Railroad retirement supplemental annuities (p. 86)
Tax 3.095	Income tax status of interest and dividends received from government and other securities by individuals and fiduciaries (p. 81)	Tax 3.91	Petition for redetermination (p. 88)
		Tax 3.94	Claims for refund (p. 89)

**Tax 3.01 Rents paid by corporations.** History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66; renum. to be (1) and cr. (2), Register, July, 1989, No. 403, eff. 8-1-89; r. Register, November, 1993, No. 455, eff. 12-1-93.

**Tax 3.03 Dividends received deduction - corporations.** (ss. 71.22 (4) and 71.26 (2) and (3) (j), Stats.) (1) **PURPOSE.** This section clarifies the deduction from gross income allowed to corporations for dividends received. Dividends may be deductible due to the payor's business activity in Wisconsin, explained in sub. (3), or due to the recipient's ownership of the payor corporation, explained in sub. (4).

(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.

Note: Refer to s. 71.26 (3) (j), Stats.

(3) **DIVIDENDS DEDUCTIBLE DUE TO PAYOR'S WISCONSIN ACTIVITY.** (a) A corporation may deduct from gross income all dividends received from a payor corporation, if the payor corporation:

1. Is subject to the Wisconsin income or franchise tax laws.
2. Filed all Wisconsin income or franchise tax returns required by law.
3. Was not entitled to deduct the dividends from gross income in computing its net income or loss for Wisconsin income or franchise tax purposes.
4. Had used 50% or more of its net income or loss, after adjustment for tax purposes, for the year preceding the payment of the dividends in computing taxable income under ch. 71, Stats., or in the case of franchise taxpayers, net income used as a measure of the franchise tax.

(b) In determining whether 50% or more of the net income or loss of the payor corporation for the year preceding the payment of the dividends was used in computing taxable income under ch. 71, Stats., or in the case of franchise taxpayers, net income used as a measure of the franchise tax, a payor corporation:

1. Which was subject to the franchise tax in the year preceding the payment of the dividends shall include interest income from the federal government and its instrumentalities.
2. Which was subject to the income tax in the year preceding the payment of the dividends may not include interest income from the federal government and its instrumentalities.

## Tax 3

Note: Refer to s. 71.26 (3) (j), Stats.

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

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

(b) The corporation receiving the dividends owns directly or indirectly during the entire taxable year in which the dividends are received at least 80% of the total combined voting stock of the payor corporation.

Note: 1) Refer to s. 71.26 (3) (j), Stats.

2) Only cash dividends were deductible by the recipient in taxable years 1980 through 1986. This limitation was eliminated by 1987 Wis. Act 27.

3) For the taxable years 1980 through 1983 the deduction under sub. (4) was limited to 50% of the dividends received.

4) For the taxable year 1984 the deduction under sub. (4) was limited to 75% of the dividends received.

5) For the taxable years 1985 and thereafter the deduction under sub. (4) equals 100% of the dividends received.

(5) **LIMITATIONS ON DEDUCTION.** (a) If dividends received from a corporation qualify for deduction under both subs. (3) and (4), only one of the deductions may be claimed.

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

(c) Dividends received shall be reduced by foreign taxes paid on those dividends and claimed as a deduction.

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

History: 1-2-56; am. Register, September, 1964, No. 105, eff. 10-1-64; am. (1), Register, March, 1966, No. 123, eff. 4-1-66; am. Register, February, 1975, No. 230, eff. 3-1-75; cr. (5), Register, July, 1978, No. 271, eff. 8-1-78; r. and recr. Register, June, 1990, No. 414, eff. 7-1-90.

Tax 3.05 Profit-sharing distributions by corporations. History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66; renum. (1) (a) to be (2) and am., cr. (3), Register, July, 1989, No. 403, eff. 8-1-89; r. Register, November, 1993, No. 455, eff. 12-1-93.

Tax 3.07 Bonuses and retroactive wage adjustments paid by corporations. History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66; am. Register, July, 1987, No. 379, eff. 8-1-87; renum. to be (1), cr. (2), Register, July, 1989, No. 403, eff. 8-1-89; r. Register, November, 1993, No. 455, eff. 12-1-93.

Tax 3.08 Retirement and profit-sharing payments by corporations. History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66; am. (1) to (3), cr. (4) to (6), Register, June, 1990, No. 414, eff. 7-1-90; r. Register, November, 1993, No. 455, eff. 12-1-93.

Tax 3.085 Retirement plan distributions. (s. 71.04 (1) (a), Stats.) (1) **NONRESIDENTS.** Employee annuity, pension, profit-sharing or stock bonus plan distributions, including self-employed retirement plan distributions, and distributions from qualified deferred compensation plans under ss. 401 (k), 403 (b) and 457 of the internal revenue code received by a person while a nonresident of Wisconsin shall be exempt from the Wisconsin income tax, regardless of whether any of these distributions may be attributable to personal services performed in Wisconsin.

Register, January, 1994, No. 457

(2) **RESIDENTS.** Employe annuity, pension, profit-sharing or stock bonus plan distributions, including self-employed retirement plan distributions, and distributions from qualified deferred compensation plans under ss. 401 (k), 403 (b) and 457 of the internal revenue code received by a person while a resident of Wisconsin shall be subject to the Wisconsin income tax, regardless of whether any of these distributions may be attributable to personal services performed outside of Wisconsin.

History: Cr. Register, March, 1978, No. 267, eff. 4-1-78; am. Register, June, 1990, No. 414, eff. 7-1-90.

**Tax 3.09 Exempt compensation of military personnel.** History: Cr. Register, August, 1976, No. 248, eff. 9-1-76; renum. (intro.) to (4) to be (2) (intro.) to (d) and am. (2) (intro.) and (b), cr. (1), Register, July, 1989, No. 403, eff. 8-1-89; r. Register, November, 1993, No. 455, eff. 12-1-93.

**Tax 3.095 Income tax status of interest and dividends received from government and other securities by individuals and fiduciaries.** (s. 71.05 (6) (a) 1 and (b) 1, Stats.) (1) **PURPOSE.** This section lists federal, state, municipal and other government securities, and certain nongovernment securities, and specifies whether interest and dividends payable on those securities are exempt from or subject to the Wisconsin income tax on individuals and fiduciaries. The lists are not all-inclusive.

Note: Information regarding the income tax status of interest and dividends received from securities not listed in this section may be obtained by writing to Wisconsin Department of Revenue, Technical Services Staff, P.O. Box 8933, Madison, WI 53708-8933.

(2) **DEFINITIONS.** In this section:

(a) "CHAP" means "Community Housing Alternatives Program."

(b) "Federal securities" means only securities which are direct and primary obligations of the United States and securities the interest on which federal law prohibits states from taxing. Federal securities do not include securities for which the United States is merely a guarantor and, therefore, has an obligation which is secondary and contingent to that of the issuer of the security.

(c) "Public housing agency" means any state, county, municipality or other governmental entity or public body, or agency or instrumentality thereof, which is authorized to engage in or assist in the development or operation of lower income housing, under 42 USC §1437a(b) (6).

(d) "WHEDA" means "Wisconsin Housing and Economic Development Authority."

(3) **GENERAL.** (a) Under s. 71.05(6) (a) 1, Stats., interest income which is subject to the Wisconsin income tax on individuals and fiduciaries, but which is not included in federal adjusted gross income, shall be added to federal adjusted gross income in computing Wisconsin taxable income.

Note: Section 71.05(1) (a) 1, 1985 Stats., was amended by 1987 Wis. Act 27, to provide for the addition to federal adjusted gross income, of any interest not included in federal adjusted gross income which is not specifically exempted from state taxation. This change applies only to securities issued after January 28, 1987. Prior to enactment of 1987 Wis. Act 27, the addition applied only to interest excluded from federal adjusted gross income solely by s. 103 of the internal revenue code. Section 71.05(1) (a) 1, 1985 Stats., was renumbered s. 71.05(6) (a) 1, Stats., by 1987 Wis. Act 312, effective January 1, 1989.

(b) Under s. 71.05(6) (b) 1, Stats., interest and dividend income which is included in federal adjusted gross income but which is by federal law

Register, January, 1994, No. 457

exempt from state income taxation, shall be subtracted from federal adjusted gross income in computing Wisconsin taxable income.

(4) **EXEMPT SECURITIES.** Interest and dividends payable on the following securities shall be exempt from the Wisconsin income tax on individuals and fiduciaries:

(a) *Exempt state, municipal and other government securities.* 1. District of Columbia general obligation bonds issued on or prior to January 28, 1987, where the interest from the bonds qualifies for exemption from federal income taxation for a reason other than or in addition to s. 103 of the internal revenue code.

2. Higher education bonds issued by the state of Wisconsin, s. 71.05(6)(a) 1, Stats.

3. Public housing agency bonds issued on or prior to January 28, 1987, by agencies located outside Wisconsin where the interest from the bonds qualifies for exemption from federal income taxation for a reason other than or in addition to s. 103 of the internal revenue code.

4. Public housing authority bonds issued by municipalities located in Wisconsin, s. 66.40(14) (a), Stats.

5. Redevelopment authority bonds issued by municipalities located in Wisconsin, s. 66.431(5) (a)4.c, Stats.

6. Stripped general obligation bond certificates attributable to certain District of Columbia general obligation bonds issued on or prior to January 28, 1987, where the interest from the bonds qualifies for exemption from federal income taxation under s. 1286 of the internal revenue code and D.C. Code Ann. § 47-332.

Example: Stripped general obligation bond certificates meeting the criteria of subd. 6 include Stripped Tax-Exempt Participations, or 'STEPS.'

7. Virgin Island Housing Authority bonds issued on or prior to January 28, 1987, where the interest from the bonds qualifies for exemption from federal income taxation for a reason other than or in addition to s. 103 of the internal revenue code.

8. WHEDA bonds issued on or prior to January 28, 1987, except business development revenue bonds, economic development revenue bonds and CHAP housing revenue bonds issued by WHEDA.

9. WHEDA bonds issued to fund a loan under s. 234.935, Stats.

10. WHEDA bonds issued under s. 234.65, Stats., to fund an economic development loan to finance construction, renovation or development of property that would be exempt under s. 70.11(36), Stats.

11. Wisconsin Housing Finance Authority bonds, 42 USC § 1437i(b).

Note: Under par. (a), interest and dividends payable on certain securities issued on or before January 28, 1987, is exempt from Wisconsin income tax. This is because prior to enactment of 1987 Wis. Act 27, which amended s. 71.05(1) (a) 1, 1985 Stats., effective with securities issued after January 28, 1987, no modification was provided to add to federal adjusted gross income interest and dividends which were excludable from federal adjusted gross income for any reason other than or in addition to s. 103 of the internal revenue code. Section 71.05(1) (a) 1, 1985 Stats., was renumbered s. 71.05(6) (a) 1, Stats., by 1987 Wis. Act 312, effective January 1, 1989.

(b) *Exempt federal securities.* 1. Armed Services Housing Mortgage Insurance debentures, 12 USC § 1748b(f).

2. Bank for Cooperative debentures, 12 USC § 2134.

3. Bank repurchase agreements for U.S. Government treasury bills, notes and bonds, if interest is paid by the federal government directly to the taxpayer.

4. Commodity Credit Corporation bonds, 15 USC § 713a-5.

5. Commonwealth of Puerto Rico public improvement bonds, 48 USC § 745.

6. Farm Credit System Financial Assistance Corporation notes, bonds and debentures, 12 USC § 2278b-10(b).

7. Federal Deposit Insurance Corporation bonds, 12 USC § 1825.

8. Federal Farm Credit Banks Consolidated Systemwide Securities, 12 USC § 2055.

9. Federal Home Loan Bank bonds, debentures and notes, 12 USC § 1433.

10. Federal Housing Authority debentures, 12 USC §§ 1710(d) and 1747g(g).

11. Federal Intermediate Credit Bank debentures, 12 USC § 2079.

12. Federal Land Bank Association bonds, notes and debentures, 12 USC § 2055.

13. Federal Land Bank bonds, 12 USC § 2055.

14. Federal Reserve Bank dividends, 12 USC § 531.

15. Federal Savings and Loan Insurance Corporation bonds, 12 USC § 1725(e).

16. Financial Assistance Corporation bonds, notes and debentures, 12 USC § 2278b.

17. Financing Corporation obligations, 12 USC § 1441.

18. General Insurance Fund debentures issued to acquire housing projects, 12 USC § 1747g(g).

19. General Insurance Fund debentures issued under the War Housing Insurance Law, 12 USC § 1739(d).

20. General Services Administration Public Building Trust Participation certificates, 31 USC § 3124.

21. Guam bonds, 48 USC § 1423a.

22. Industrial Development bonds of East Samoa, 48 USC § 1670.

23. Panama Canal Zone bonds, 31 USC §§ 743-745.

24. Production Credit Association debentures, 12 USC § 2098.

25. Proprietary zero-coupon certificates, 31 USC § 3124.

## Tax 3

Example: Proprietary zero-coupon certificates include CATS, TIGRs, Cougars, ETRs, Lions, STARS, Zebras, etc.

26. Puerto Rico Aqueduct and Sewer Authority revenue bonds, 48 USC § 745.

27. Puerto Rico Electric Power Authority electric revenue bonds, 48 USC § 745.

28. Puerto Rico Electric Power Authority power revenue bonds, 48 USC § 745.

29. Puerto Rico Highway Authority revenue bonds, 48 USC § 745.

30. Puerto Rico Industrial Development Company bonds, 48 USC § 745.

31. Puerto Rico Municipal Finance Agency 1974 Series A bonds, 48 USC § 745.

32. Puerto Rico Ports Authority revenue bonds, 48 USC § 745.

33. Puerto Rico Public Buildings Authority public education and health facility bonds, 48 USC § 745.

34. Puerto Rico Public Buildings Authority revenue bonds, 48 USC § 745.

35. Puerto Rico Telephone Authority revenue bonds, 48 USC § 745.

36. Puerto Rico Water Resource Authority Series B debentures, 48 USC § 745.

37. Resolution Funding Corporation bonds, 12 USC § 1441b(f) (7).

38. Student Loan Marketing Association obligations, 20 USC § 1087-21.

39. Tennessee Valley Authority bonds, 16 USC § 831n-4(d).

40. Territory of Hawaii bonds.

41. Territory of Puerto Rico bonds, 48 USC § 745.

42. United States Postal Service bonds, 39 USC § 2005.

43. United States savings bonds, 31 USC § 3124.

44. United States Treasury bills and notes, 31 USC § 3124.

45. University of Puerto Rico university system revenue bonds, 48 USC § 745.

46. Virgin Islands general obligation bonds, 48 USC § 1574(b) (ii) (A).

47. Virgin Islands Public Improvement bonds, 48 USC § 1574(b) (i).

(5) TAXABLE SECURITIES. Interest and dividends payable on the following securities shall be subject to the Wisconsin income tax on individuals and fiduciaries:

(a) *Taxable state and municipal government securities.* 1. District of Columbia Development Land Agency bonds, 42 USC § 1452.

Register, January, 1994, No. 457

2. District of Columbia general obligation bonds issued after January 28, 1987, D.C. Code § 47-33.

3. Municipal bonds.

4. Public housing agency bonds issued after January 28, 1987, and by agencies located outside Wisconsin. Public housing agency bonds issued on or prior to January 28, 1987, by agencies located outside Wisconsin where the interest from the bonds qualifies for exemption from federal income taxation solely because of s. 103 of the internal revenue code.

5. Robert F. Kennedy Stadium bonds, D.C. Code § 2-1720 et seq.

6. Transit bonds of the Washington Metropolitan Area Transit Authority.

7. Wisconsin Health Education Assistance Loan revenue obligation bonds, s. 39.374, Stats.

8. WHEDA bonds issued after January 28, 1987, and all business development revenue bonds, economic development revenue bonds and CHAP housing revenue bonds issued by WHEDA, regardless of when issued, unless specifically exempt by law, ch. 234, Stats.

(b) *Other taxable securities.* 1. Asian Development Bank bonds, 22 USC § 2901-9.

2. College Construction Loan Insurance Association obligations, 20 USC § 1132.

3. Environmental Financing Authority obligations, 33 USC § 1281.

4. Export-Import Bank of the United States debentures, 12 USC § 635.

5. Farmer's Home Administration insured notes, 7 USC §§ 1928 and 1929.

6. Federal Assets Financing Trust participation certificates, 12 USC § 1717(c).

7. Federal Financing Bank bonds, 12 USC § 2288.

8. Federal Home Loan Bank dividends, 12 USC §§ 1426 and 1436.

9. Federal Home Loan Mortgage Corporation obligations, 12 USC § 1455.

10. Federal National Mortgage Association certificates, 12 USC § 1718.

Note: In 1968, the Federal National Mortgage Association became 2 separate corporations. One corporation retained the original name and the other is known as the Government National Mortgage Association.

11. Federal National Mortgage Association dividends, 12 USC § 1719.

12. Government National Mortgage Association, or 'Ginnie Mae,' bonds, 12 USC §§ 1720 and 1721.

13. HUD/New Communities Program obligations, 42 USC § 4514.

14. Insured Merchant Marine bonds, 46 USC § 1273.

15. Inter-American Development Bank bonds, 22 USC § 283.

16. Interest paid on deposits in any federal bank or agency.
17. International Bank for Reconstruction and Development bonds, also known as World Bank bonds, 22 USC § 286.
18. Rural Telephone debentures, 7 USC § 947(a).
19. Small Business Administration notes, 15 USC § 633.
20. Small Business Investment Company debentures, 15 USC §§ 683 and 687.
21. Tennessee Valley Authority bonds, 16 USC § 831n-3.
22. Virgin Islands Housing Authority bonds issued after January 28, 1987, 48 USC § 1408(a).
23. World Bank bonds, also known as International Bank for Reconstruction and Development bonds, 22 USC § 286.

History: Cr. Register, August, 1976, No. 248, eff. 9-1-76; emerg. cr. (1) (g) to (i), am. (2) (intro.), r. (2) (b), (h) and (j), eff. 7-31-87; r. and recr. Register, April, 1988, No. 388, eff. 5-1-88; emerg. am. (3) (intro.) and (c), cr. (3) (g), r. and recr. (4) (b), eff. 1-1-89; am. (2) (intro.), (3) (intro.), (c), (f), (4) (intro.) and (b), cr. (4) (c) to (f), Register, August, 1989, No. 404, eff. 9-28-89; cr. (1) (a), (b), (f), (g), (i), (q), (r) and (v), (2) (a), (d), (f), (g), (m), (o), (p) to (u), (w), (zh), (zq) and (zr), (4) (b) and (e); renum. (1) (a) to (n), (2) (a) to (zb), (4) (a), (b), (d) and (e) to be (1) (c) to (e), (h), (j) to (p), (s) to (u), (2) (b), (c), (e), (h) to (l), (n), (v), (x) to (zd), (zf), (ze), (zg), (zi) to (zp), (4) (d), (h), (g) and (a) and am. (1) (p), Register, June, 1991, No. 426, eff. 7-1-91; r. and recr. Register, January, 1994, No. 457, eff. 2-1-94.

**Tax 3.096 Interest paid on money borrowed to purchase exempt government securities.** (s. 71.05 (6) (b) 1, Stats.) (1) Any amount of distributable and nondistributable interest or dividend income which is by federal law exempt from the Wisconsin income tax shall be reduced by any related expense before it is claimed as a subtraction modification on a Wisconsin fiduciary income tax return.

(2) Interest expense is a "related expense" if it is incurred to purchase securities producing exempt interest or dividend income and if it is deducted in computing Wisconsin taxable income.

(3) Interest expense is not a "related expense" if it is incurred to purchase securities producing exempt interest or dividend income but is not deducted in computing Wisconsin taxable income (for example, because the taxpayer elects the standard rather than to itemize deductions).

Note: 1) For taxable year 1987, the subtraction modification for the amount of distributable and nondistributable exempt interest and dividend income did not have to be reduced by related expenses before it was claimed on a Wisconsin fiduciary return as a result of amendment to s. 71.05 (1) (b) 1 by 1987 Wis. Act 27.

2) For taxable years prior to 1986, individual taxpayers were required to reduce the amount of interest or dividend income which was by law exempt from Wisconsin income tax by any related expense before the income was claimed as a subtraction modification on a Wisconsin individual income tax return if the related expense was deducted in computing Wisconsin taxable income.

Register, January, 1994, No. 457



DEPARTMENT OF REVENUE

86-1

Tax 3

Examples:	1) U.S. bond interest exempt from Wisconsin income tax.	\$ 600
	Interest which was paid on funds used to acquire exempt securities and which was claimed as an itemized deduction.	<u>400</u>
	Subtraction modification.	<u>\$ 200</u>
	2) U.S. bond interest exempt from Wisconsin income tax.	\$ 400
	Interest paid to acquire the exempt securities which was claimed as an itemized deduction.	<u>600</u>
	Subtraction modification.	<u>\$ 0</u>
	3) U.S. bond interest exempt from Wisconsin income tax.	\$ 400
	Interest paid to acquire the exempt securities but <i>not</i> claimed as an itemized deduction.	<u>600</u>
	Subtraction modification.	<u>\$ 400</u>

History: Cr. Register, January, 1977, No. 253, eff. 2-1-77; am. (1), Register, June, 1990, No. 414, eff. 7-1-90.

**Tax 3.098 Railroad retirement supplemental annuities.** (s. 71.05 (6) (b) 3, Stats.). Railroad retirement supplemental annuities paid under 45 USC s. 231m are exempt from the Wisconsin taxable income of their recipients.

Note: 1) The Railroad Retirement Act of 1974 as amended by P.L. 98-76 (45 USC s. 231m), effective August 12, 1983, provides that:

*"(a) Except as provided in subsection (b) of this section and the Internal Revenue Code of 1954 (26 USCS §§ 1 et seq.), notwithstanding any other law of the United States, or of any State . . . no annuity or supplemental annuity shall be . . . subject to any tax. . . ."*

Next page is numbered 87