

Chapter Tax 3

INCOME TAXATION, DEDUCTIONS FROM GROSS INCOME, EXCLUSIONS AND EXEMPTIONS, ETC.

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Tax 3.01 Rents paid by corporations. (s. 71.04 (2), Stats.) Rents paid on property used in producing taxable income are deductible from gross income. The cost of leaseholds, acquired for cash or property, represents rent paid in advance and as such is deductible from gross income in equal amounts over the life of the leaseholds. Taxes paid by the lessee for the lessor are to be treated as additional rent paid and are a deductible expense.

History: 1-2-56; am. Register, March, 1966, No. 123. eff. 4-1-66.

Tax 3.03 Dividends received, deductibility of. (s. 71.04 (4), Stats.) (1) In determining whether 50% or more of the net income or loss for the preceding year of the corporation paying the dividend was used in computing taxable income, if the corporation paying the dividend was subject to the franchise tax measured by net income, interest income from the federal government and its instrumentalities must be included but deduct-

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ible dividends must be disregarded. If the corporation paying the dividend was subject to the net income tax, non-taxable interest from the federal government or its instrumentalities and deductible dividends must both be disregarded.

(2) When a corporation keeps its records on the basis of a fiscal year ending not later than June 30, the dividends received from such corporation during the calendar year will be presumed to have been paid from the income of the corporation for its fiscal year ending within the calendar year when such dividends are paid. When a corporation keeps its records on the basis of a fiscal year ending subsequent to June 30, the dividends received from such corporation during the calendar year will be presumed to have been paid from the income of the corporation for its fiscal year ending in the year prior to the calendar year when such dividends are paid.

(3) All dividends must be reported in full on the income tax return of the person receiving them, regardless of the deductibility of certain dividends received by corporations. Corporate taxpayers should deduct such dividends as they believe to be deductible. Whether or not the dividends are deductible will be determined in accordance with the records on file with the department of revenue and proper adjustment will be made.

(4) All corporations doing business within Wisconsin must report the dividends paid to residents of Wisconsin on forms 9b. (See s. Tax 2.04).

(5) Distributions received from corporations which may deduct dividends paid from gross income for tax purposes do not qualify as deductible dividends.

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.

Tax 3.05 Profit-sharing distributions by corporations. (s. 71.04 (1), Stats.) (1) Payments made to officers and employes for services rendered under the terms of a profit-sharing agreement, in lieu of or in addition to fixed salaries or other compensation, are proper deductions from gross income. Payments made to the stockholders of a corporation who are not actively engaged in the business are not allowable deductions. If profit-sharing distributions are based on stock holdings, they will be treated as dividends and, therefore, are not allowable deductions.

(a) The form or method of fixing compensation is not decisive as to the deductibility thereof. If payments are made pursuant to a profit-sharing agreement entered into between employer and employe before services are rendered, which is not influenced by any consideration on the part of the employer other than that of securing the services of the employe on fair and advantageous terms, they will be allowable as deductions from gross income even though in the actual working out of the contract such payments may prove to be greater than the amounts which would ordinarily be paid.

History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66.

Tax 3.07 Bonuses and retroactive wage adjustments paid by corporations. (s. 71.04 (1), Stats.) Bonuses for services actually rendered but not based upon a prearranged bonus agreement or established policy are allowable when actually paid, provided the payments when added to the stipulated

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salaries or other compensation do not exceed a reasonable compensation for the services rendered. Bonuses paid to employees and others which do not have in them the element of compensation or are excessive in comparison to the services rendered are not deductible from gross income. Christmas bonuses, if paid as additional compensation, are proper deductions from gross income if included on federal form W-2 or Wisconsin form 9b as a part of the compensation paid. Retroactive wage adjustments, if reasonable in amount, may be taken as a deduction from gross income in the year in which they are finally determined to be payable. The adjustments are to be reported on federal form W-2 or Wisconsin form 9b.

History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66; am. Register, July, 1987, No. 379, eff. 8-1-87.

Tax 3.08 Retirement and profit-sharing payments by corporations. (s. 71.04, Stats.) (1) Retirement payments to retired officers or employees or to their families or dependents, to be deductible from gross income must:

- (a) Qualify as ordinary and necessary expense.
- (b) Be made pursuant to a retirement plan agreement.
- (c) Be reasonable in amount.
- (d) Have been reported on informational returns when required by s. Tax 2.04 or 2.06.

Credits to retirement reserves are not deductible, but actual retirement payments made and charged against such reserves may be deductible in the year made.

(2) Payments to an employe retirement or profit-sharing trust are deductible if:

- (a) Such payments qualify as ordinary and necessary expense.
- (b) The trust is an irrevocable trust and no part of its funds may revert to the employer.
- (c) Payments to the trust are made in accordance with an established policy or agreement.
- (d) The trust is established for the benefit of officers or employes.
- (e) Such payments are reasonable in amount.

History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66.

Tax 3.085 Retirement plan distributions. (s. 71.07 (1), Stats.) (1) **NON-RESIDENTS.** Employe annuity, pension, profit-sharing or stock bonus plan distributions (including self-employed retirement plan distributions) 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.

(2) **RESIDENTS.** Employe annuity, pension, profit-sharing or stock bonus plan distributions (including self-employed retirement plan distributions) received by a person while a resident of Wisconsin shall be subject to the Wisconsin income tax, regardless of whether any of these distribu-

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tions may be attributable to personal services performed outside of Wisconsin.

History: Cr. Register, March, 1978, No. 267, eff. 4-1-78.

Tax 3.09 Exempt compensation of military personnel. (s. 71.01 (3) (f), Stats.) For purposes of the income tax exemption of the first \$1,000 of compensation received from the United States as a reserve or active member of the armed forces under s. 71.01 (3) (f), Stats.:

(1) Compensation received by members of the Wisconsin national guard from the state for weekend highway patrol duty, civil disturbance or riot duty shall not qualify for this exemption.

(2) Compensation received by retired officers and enlisted personnel of the armed services from the United States shall not qualify for this exemption except as provided under sub. (4).

(3) Compensation received by commissioned officers of the United States, such as public health officers or coast and geodetic survey officers, who are not members of the armed services shall not qualify for this exemption.

(4) Compensation received by retired, enlisted personnel of the armed services who upon retirement are transferred to reserve units until completion of 30 years of service shall qualify for this exemption. This includes compensation received by retired army and air force personnel who are transferred to reserve units and by retired navy and marine personnel who are transferred to fleet reserve and fleet marine corps reserve, respectively.

Note: Under s. 71.01 (3) (f), Stats., the first \$1,000 of compensation received from the United States for service as a reserve or active member of the armed forces is exempt from income taxation. This rule clarifies how several types of payments will be treated under this exemption.

History: Cr. Register, August, 1976, No. 248, eff. 9-1-76.

Tax 3.095 Income tax status of interest and dividends from municipal, state and federal obligations received by individuals and fiduciaries. (s. 71.05 (1) (a) 1 and (b) 1, Stats.) (1) Interest and dividends, less related expenses, payable on the following securities shall be subject to state income tax on individuals and fiduciaries:

(a) District of Columbia Development Land Agency bonds, 42 U.S.C. § 1452.

(b) Export-Import Bank of the United States debentures, 12 U.S.C. § 635.

(c) Farmer's Home Administration insured notes, 7 U.S.C. §§ 1928 and 1929.

(d) Federal Home Loan Bank dividends, 12 U.S.C. §§ 1426 and 1436.

(e) Federal National Mortgage Association certificates, 12 U.S.C. § 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.

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(f) Federal National Mortgage Association dividends, 12 U.S.C. § 1719.

(g) Government National Mortgage Association (Ginnie Mae) bonds, 12 U.S.C. §§ 1720 and 1721.

(h) Insured Merchant Marine bonds, 46 U.S.C. § 1273.

(i) Inter-American Development Bank bonds, 22 U.S.C. § 283.

(j) Interest paid on deposits in any federal bank or agency.

(k) International Bank for Reconstruction and Development bonds, 22 U.S.C. § 286.

(l) Small Business Investment Company debentures, 15 U.S.C. §§ 683 and 687.

(m) Tennessee Valley Authority bonds, 16 U.S.C. § 831n-3.

(n) Transit bonds of the Washington Metropolitan Area Transit Authority.

(2) Interest and dividends payable on the federal securities listed in pars. (a) to (zb) shall be exempt from state income tax on individuals and fiduciaries. For purposes of this subsection, the term, "federal securities" means only securities which are direct and primary obligations of the United States and securities the interest of 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.

(a) Bank for Cooperative debentures, 12 U.S.C. § 2134.

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

(c) Commonwealth of Puerto Rico public improvement bonds, 48 U.S.C. § 745.

(d) Federal Farm Credit Banks Consolidated Systemwide Securities, 12 U.S.C. § 2055.

(e) Federal Home Loan Bank bonds, debentures, and notes, 12 U.S.C. § 1433.

(f) Federal Housing Authority debentures, 12 U.S.C. §§ 1710 (d) and 1747g (g).

(g) Federal Intermediate Credit Bank debentures, 12 U.S.C. § 2079.

(h) Federal Land Bank bonds, 12 U.S.C. § 2055.

(i) Federal Reserve Bank dividends, 12 U.S.C. § 531.

(j) Production Credit Association debentures, 12 U.S.C. § 2098.

(k) Puerto Rico Aqueduct and Sewer Authority revenue bonds, 48 U.S.C. § 745.

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(l) Puerto Rico Electric Power Authority electric revenue bonds, 48 U.S.C. § 745.

(m) Puerto Rico Electric Power Authority power revenue bonds, 48 U.S.C. § 745.

(n) Puerto Rico Highway Authority revenue bonds, 48 U.S.C. § 745.

(o) Puerto Rico Industrial Development Company bonds, 48 U.S.C. § 745.

(p) Puerto Rico Municipal Finance Agency 1974 Series A bonds, 48 U.S.C. § 745.

(q) Puerto Rico Ports Authority revenue bonds, 48 U.S.C. § 745.

(r) Puerto Rico Public Buildings Authority revenue bonds, 48 U.S.C. § 745.

(s) Puerto Rico Public Buildings Authority public education and health facility bonds, 48 U.S.C. § 745.

(t) Puerto Rico Telephone Authority revenue bonds, 48 U.S.C. § 745.

(u) Student Loan Marketing Association obligations, 20 U.S.C. § 1087-2l.

(v) Tennessee Valley Authority bonds, 16 U.S.C. § 831n-4(d).

(w) Territory of Hawaii bonds.

(x) Territory of Puerto Rico bonds, 48 U.S.C. § 745.

(y) United States Postal Service bonds, 39 U.S.C. § 2005.

(z) United States savings bonds, 31 U.S.C. § 3124.

(za) United States Treasury bills and notes, 31 U.S.C. § 3124.

(zb) University of Puerto Rico university system revenue bonds, 48 U.S.C. § 745.

(3) Interest and dividends, less related expenses, payable on the state, municipal, and other local government securities listed in pars. (a) to (f) shall be subject to the state income tax on individuals and fiduciaries.

(a) District of Columbia general obligation bonds issued after January 28, 1987, s. 47-33, District of Columbia Code.

(b) Municipal bonds.

(c) Public housing authority bonds issued by municipalities located outside Wisconsin.

(d) Virgin Islands Housing Authority bonds issued after January 28, 1987, 48 U.S.C. § 1408(a).

(e) Wisconsin Health Education Assistance Loan revenue obligation bonds, s. 39.374, Stats.

(f) Wisconsin Housing and Economic Development Authority bonds issued after January 28, 1987, s. 234, Stats.

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(4) Interest and dividends payable on the housing authority bonds listed below shall be exempt from the state income tax on individuals and fiduciaries.

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

(b) Wisconsin Public Housing Authority bonds, 42 U.S.C. § 1437i(b). emergency
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Note: This rule sets out examples of interest and dividends payable on state, municipal and federal obligations which are taxable and tax exempt.

Section 71.05 (1) (a) 1, Stats., provides for the inclusion in Wisconsin income of natural persons and fiduciaries of any interest, less related expenses, received on state and municipal obligations.

Section 71.05 (1) (b) 1, Stats., provides for the exclusion from Wisconsin income of natural persons and fiduciaries of any interest or dividend income which is by federal law exempt from taxation by Wisconsin.

For periods prior to August 1, 1987, interest accrued from District of Columbia Development Land Agency bonds, Export-Import Bank of the United States debentures, Farmer's Home Administration insured notes, Government National Mortgage Association bonds, Small Business Investment Company debentures and transit bonds of the Washington Metropolitan Area Transit Authority was not subject to the Wisconsin income tax if payment of principal and interest on such obligations was guaranteed by the United States. As a result of the U.S. Supreme Court decision in the case of *Rockford Life Insurance Company v. Illinois Department of Revenue et al.*, the Department of Revenue does not consider these financial instruments to be direct and primary obligations of the United States so as to qualify for exemption from state income taxation. Therefore, by emergency rule effective August 1, 1987, the Department of Revenue amended this rule to reverse its prior interpretation and to provide that interest which accrues on these financial instruments on or after August 1, 1987, is subject to Wisconsin income tax.

Interest accrued on the following securities issued on or before January 28, 1987, is not subject to Wisconsin income tax because no modification is provided for in Wisconsin law that would add to federal adjusted gross income interest excluded from federal adjusted gross income by any reason other than section 103 of the Internal Revenue Code:

1. District of Columbia general obligation bonds.
2. Virgin Island Housing Authority bonds.
3. Wisconsin Housing and Economic Development Authority bonds.

Interest accruing on these securities is subject to Wisconsin income tax if the security was issued after January 28, 1987. 1987 Wisconsin Act 27 amended s. 71.05 (1) (a) 1, Wis. Stats., to provide for the addition to federal adjusted gross income, of interest, less related expense, which is not included in federal adjusted gross income and not specifically exempted from state taxation. Previously this addition only applied to interest excluded from federal adjusted gross income by section 103 of the Internal Revenue Code.

Interest on Wisconsin Health Education Assistance Loan revenue obligation bonds is subject to Wisconsin income tax whether the security was issued before, on, or after January 28, 1987.

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.

Tax 3.096 Interest paid on money borrowed to purchase exempt government securities (s. 71.05 (1) (b) 1, Stats.). (1) Any amount of 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 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.

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(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: The following examples illustrate the proper treatment of the interest expense described in this rule:

<i>Example A:</i>	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>
<i>Example B:</i>	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>
<i>Example C:</i>	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.

Tax 3.098 Railroad retirement supplemental annuities. (s. 71.05 (1) (b) 4, Stats.). Railroad retirement supplemental annuities paid under 45 U.S.C.A. s. 228c are exempt from the Wisconsin taxable income of their recipients.

Note: The Railroad Retirement Act (45 U.S.C.A. s. 428L) provides that, "Notwithstanding any other law of the United States, or of any State . . . no annuity or pension payment shall be . . . subject to any tax. . . ."

Another provision of the Act (45 U.S.C.A. s. 228c (j) (3)), however, relates specifically to supplemental Retirement Annuities paid in amounts between \$45 and \$70 per month, and qualifies the above provision by stating "The provisions of Section 228L of this title shall not operate to exclude the supplemental annuities herein provided for from income taxable pursuant to the Federal income tax provisions of Title 26."

While such supplemental annuities are taxable for federal income tax purposes, 45 U.S.C.A. s. 228 (c) (j) 3 continues to prohibit states from taxing the payments. As the supplemental annuity must be reported for federal income tax purposes, a Wisconsin taxpayer may make a modification to federal adjusted gross income to remove such income from Wisconsin adjusted gross income.

History: Cr. Register, January, 1977, No. 253, eff. 2-1-77.

Tax 3.10 Salesmen's and officers' commissions, travel and entertainment expense of corporations. (s. 71.04 (1) and (2), Stats.) (1) Commissions, lump sum and per diem allowances for travel, entertainment and other expenses, or allowances for use of automobiles, are deductible from gross income, if such items are reported on form WT-9 or 9b. Reimbursement of amounts actually expended by officers, employes or others for ordinary and necessary expenses of a taxpayer are deductible if it is proven that the amounts thus reimbursed were actually so expended.

(2) Effective for the 1976 taxable year and thereafter, money or the value or cost of property given to or spent on behalf of a public official is not deductible. "Public official" includes any elected or appointed official, any candidate for public office and any employe of the United States or any state or a political subdivision thereof.

History: 1-2-56; am. Register, September, 1964, No. 105, eff. 10-1-64; am. register, March, 1966, No. 123, eff. 4-1-66; am. Register, July, 1978, No. 271, eff. 8-1-78.

Tax 3.12 Losses on account of wash sales by corporations. (s. 71.04 (7), Stats.) The provision for the disallowance of losses from so-called "wash sales" is not applicable to dealers in securities or to persons who continually deal in securities on the stock market and who do not retain possession of their securities for any substantial period of time.

History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66.

Tax 3.14 Losses from bad debts by corporations. (s. 71.04 (7), Stats.) (1) Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction.

(2) Bad debts arising from items of income are not deductible unless the items in question have been reported for taxation. For example, bad debts arising from unpaid rents and similar items of taxable income will not be allowed as a deduction unless the income such items represent has been included in the return of income for the year for which the deduction as a bad debt is sought to be made or for a previous year.

(3) Any amount subsequently received on account of a bad debt previously allowed as a deduction for income tax purposes, must be included in gross income for the taxable year in which received.

(4) There should accompany the return a statement of facts substantiating any deduction claimed for bad debts.

History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66.

Tax 3.17 Corporation losses, miscellaneous. (s. 71.04 (7), Stats.) (1) Premiums paid on bonds purchased are part of the cost of such bonds, and no portion of such premiums will be allowed as deductions from gross income until the bonds are sold or redeemed.

(2) Losses sustained from illegal transactions are not deductible.

(3) Anticipated losses set up on the books through reserves for contingencies, etc., are not deductible.

History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66.

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Tax 3.24 Corporation taxes, miscellaneous. (s. 71.04 (3), Stats.) (1) Import or tariff duties and business, license, privilege, excise and stamp taxes, are deductible if incurred in connection with the operation of the taxpayer's trade or business.

(2) Fees or taxes paid in connection with the organization of corporations, or the increase of capital stock after organization, are not deductible in the year of payment. Such fees and taxes are part of the organization expense and must be capitalized. (See Tax 3.44)

History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66.

Tax 3.35 Depletion, basis for allowance to corporations. (s. 71.04 (2), Stats.) The capital sum recoverable through depletion allowances is the tax cost of the depletable property. In the absence of competent evidence to the contrary, it will be assumed that the fair market value at January 1, 1911, is represented by the actual cost less depletion sustained to that date. No depletion is deductible on property acquired subsequent to January 1, 1911, the cost of which was deducted as current expense at the time of purchase and allowed for income tax purposes. After depletion of the tax cost to the extent of 100% has been allowed, no further deduction is permissible.

History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66.

Tax 3.36 Depletion of timber by corporations. (s. 71.04 (2), Stats.) The computation of the allowance for depletion of timber for a given year shall be based upon the number of units of timber cut during that year and the tax cost of each unit. The unit cost is determined by dividing the sum of the tax cost at the beginning of the taxable period and the additions at cost during the period by the sum of the units on hand at the beginning of the taxable period and the number of units acquired during such period.

History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66.

Tax 3.37 Depletion of mineral deposits by corporations. (s. 71.04 (2), Stats.) The computation of the allowance for depletion of mineral deposits for a given year shall be based upon the number of units of ore or other deposits extracted during the year and the income tax cost per unit.

History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66.

Tax 3.38 Depletion allowance to incorporated mines and mills producing or finishing ores of lead, zinc, copper or other metals except iron. (s. 71.046, Stats.) Section 71.046, created by chapter 370, Laws of 1947 and amended by chapter 438, Laws of 1953, provides for a deduction of prescribed percentages of gross income from sales of the ore or ore products of lead, zinc, copper or other mines, (except iron mines) and of mills finishing the products of such mines for the smelter.

(1) This depletion deduction may be taken only if the saving in tax due to such deduction is used by the taxpayer in prospecting for ore and duly verified proof thereof is furnished the department of revenue.

(2) Only expenditures in prospecting for ore made during or within 12 months after the close of the year for which the depletion deduction is taken will serve to fulfill the requirement that the tax savings be so used. Unless proof of expenditure is furnished within 24 months after the close of the income year for which the deduction for depletion was made, the

taxpayer will be subject to an additional assessment based on the disallowance of the deduction taken.

History: 1-2-56; am. (1); Register, September, 1964, No. 105, eff. 10-1-64; am. Register, February, 1975, No. 230, eff. 3-1-75.

Tax 3.43 Amortization of trademark or trade name expenditures—corporations. (s. 71.04(2e), Stats.) (1) **ELECTION.** If a corporation elects to amortize a trademark or trade name expenditure under s. 71.04(2e), Stats.:

(a) The election for a particular trademark or trade name expenditure is irrevocable.

(b) Each trademark or trade name expenditure may be treated differently by the taxpayer (for example, a taxpayer may elect to amortize one trademark but not another, and the length of amortization periods for 2 trade names may vary).

(c) The corporation shall attach to its tax return a statement similar to that required by para. 1.177-1(c) of the Internal Revenue Code regulations.

(2) **RECORD KEEPING.** Trademark and trade name expenditures amortized under s. 71.04(2e), Stats., shall be kept in a separate account on a taxpayer's books and records.

(3) **EFFECT OF ELECTION ON BASIS.** Upon sale or other disposition of a trademark or trade name amortized under s. 71.04(2e), Stats., in which gain or loss is recognized, an adjustment to basis shall be made in computing gain or loss for any such amortization allowed or allowable.

History: Cr. Register, July, 1977, No. 259, eff. 8-1-77.

Tax 3.44 Organization and financing expenses—corporations. (s. 71.04(7), Stats.) (1) Expenses in connection with the organization or reorganization of a business enterprise, such as fees for incorporating, attorneys', accountants' and appraisers' charges, and commissions and other expenses in the issuance or sale of capital stock, are properly capitalized when incurred or paid. Such expenses are not deductible from gross income until the business for which the expenses were incurred is abandoned and the business organization itself, or, in the case of reorganization, the successor to the business organization, has been dissolved, or has completely wound up its affairs, whichever is later.

(2) This rule, insofar as it relates to "organizational expenditures" as defined in s. 71.04 (2d) (b), Stats., as enacted in chapter 390, laws of 1969, is superseded by s. 71.04 (2d) with respect to such expenditures paid or incurred on or after February 19, 1970 and in a taxable year beginning after December 31, 1969.

History: 1-2-56 am. Register, March, 1966, No. 123, eff. 4-1-66; am. Register, August, 1970, No. 176, eff. 9-1-70.

Tax 3.45 Bond premium, discount and expense—corporations. (s. 71.04(2), Stats.) If bonds are issued at a discount or premium, the net amount of the discount or premium shall be amortized over the life of the bonds. Except as provided in s. 71.04 (15) (g), Stats., if bonds are retired at a price in excess of or less than the issuing price, the profit or loss resulting is taxable income or deductible expense in the year in which the bonds

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are retired, if proper adjustment is made for the discount or premium previously reflected in income and in all cases bond expenses shall be amortized over the life of the bonds. If a bond issue is refunded with another bond issue before the first issue matures, any unamortized discount or expense that is applicable to the first issue shall be deducted as current expense in the year that the refinancing takes place and any unamortized premium shall be taken up as income in such year.

History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66; am. Register, July, 1978, No. 271, eff. 8-1-78.

Tax 3.47 Legal expenses and fines—corporations. (s. 71.04 (2), Stats.) Legal expenses incurred in connection with the operation of a taxpayer's business are proper deductions, unless such business is conducted in violation of law. Fines are not deductible.

History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66.

Tax 3.48 Research or experimental expenditures. (s. 71.04(2f), Stats.) (1) DEFINITIONS. In this section:

(a) "Research or experimental expenditures" mean expenditures incurred in connection with the taxpayer's trade or business which represent research and development costs in the experimental or laboratory sense. The term includes generally all such costs incident to the development of an experimental or pilot model, a plant process, a product, a formula, an invention or similar property, and improvements to such already existing property and the cost of obtaining a patent, such as attorney's fees expended in making or perfecting a patent application but not the costs of acquiring another's patent, model, production, or process. The term does not include expenditures such as those for the ordinary testing or inspection of materials or products for quality control, management studies, consumer surveys, advertising or promotions or expenditures paid or incurred for research in connection with literary, historical, or similar projects, nor land or depreciable property whether incurred by the taxpayer or by another person or organization on its behalf, to the extent of the cost of the component materials of the depreciable property, the costs of labor or other elements involved in its construction and installation or cost attributable to the acquisition or improvement of the property.

(b) "Paid or incurred" shall be construed according to the method of accounting used by the taxpayer in computing taxable income.

(2) DEDUCTION. Subject to certain limitations, a corporate taxpayer may elect to either deduct research and experimental expenditures paid or incurred during a taxable year beginning after December 31, 1969 in the year paid or incurred, or to defer such expenditures and amortize them over a period of not less than 60 months selected by the taxpayer beginning with the month in which the taxpayer first realizes benefits from the expenditures, or to depreciate the expenditures over the useful life of the property to which they relate.

(a) *Election to treat as expense.* Election to treat research or experimental expenditures as expenses may be made by claiming such expenses as a deduction on the return for the year in which paid or incurred. The election shall apply to all research or experimental expenditures paid or in-

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curred in the taxable year of adoption and all subsequent years unless a different method is authorized by the secretary of revenue or a delegate.

(b) *Election to amortize.* 1. If a taxpayer has not elected to deduct research or experimental expenditures as currently deductible expenses, it may elect to treat as deferred expenses which may be amortized ratably over a period of not less than 60 months as selected by the taxpayer those expenditures which are chargeable to a capital account with no determinable useful life. However, if the property resulting from the expenditures has a determinable useful life, the capitalized expenditures or the unamortized balance thereof shall be amortized or depreciated over the determinable useful life.

2. The election to defer and amortize shall be made by attaching a signed statement to the taxpayer's return for the first taxable year to which the election is applicable and shall set forth the information required under subparagraph 1.174-4(b)(1) of the internal revenue code regulations.

(c) *Change in method or period.* Permission to change to a different method of treating research or experimental expenditures or to a different period of amortization of deferred expenses shall be required from the secretary of revenue in writing. A request for permission shall be addressed to the secretary of revenue, P.O. Box 80, Madison, Wisconsin 53701. The request shall include the name, address and signature of the taxpayer and shall be filed not later than the end of the first taxable year in which the different method is to be used. The request shall set forth the information required under either subparagraph 1.174-3(a)(3) or subparagraph 1.174-4(b)(2) of the internal revenue code regulations.

(3) **EFFECT ON BASIS.** Research and experimental expenditures not deducted currently are chargeable to a capital account and shall be added to the basis of the property resulting from such expenditures. Upon the sale or other disposition of such property in which a gain or loss is recognized an adjustment to basis shall be made in computing gain or loss for any amortization allowed or allowable.

History: Cr. Register, February, 1978, No. 266, eff. 3-1-78.

Tax 3.52 Automobile expenses—corporations. (s. 71.04 (2), Stats.) If an automobile is used exclusively for business purposes, the actual expenses of operation, including gasoline, oil, license fees, insurance premiums and depreciation, are deductible from gross income. If the automobile is used partly for business and partly for personal purposes, the expenses of operation, including gasoline, oil, license fees, insurance premiums, depreciation, chauffeur's salary, etc., may be apportioned on the basis of the mileage devoted to business and personal uses, and the amount allocated to business purposes will constitute an allowable deduction from the taxable income derived therefrom.

History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66.

Tax 3.54 Miscellaneous expenses not deductible—corporations. (s. 71.04 (2), Stats.) Miscellaneous expenses which are not properly deductible in arriving at taxable net income include the following:

(1) Charges made by a corporation against its income or surplus covering expenses incurred for personal purposes of its officers, stockholders or

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employes, unless reported as compensation paid on form WT-9 or form 9b.

(2) Dues to fraternal orders, social clubs.

(3) Political contributions.

(4) For the 1976 taxable year and thereafter, any expenses incurred for or on behalf of a public official.

History: 1-2-56; am. Register, February, 1960, No. 50, eff. 3-1-60; am. Register, September, 1964, No. 105, eff. 10-1-64; am. Register, March, 1966, No. 123, eff. 4-1-66; am. Register, July, 1978, No. 271, eff. 8-1-78.

Tax 3.55 Donations and contributions—corporations. (s. 71.04 (5), Stats.) (1) Contributions by corporations may be deducted only if the recipient is operating within Wisconsin.

(2) No deductions for contributions, donations or gifts is allowable if the income tax return of the taxpayer before deducting such contributions, donations or gifts shows a loss.

(3) Deductions for contributions, donations or gifts are not allowable unless the name and address of each recipient and the amount given each recipient is listed in the income tax return of the taxpayer.

History: 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66.

Miscellaneous

Tax 3.81 Offset of occupational taxes paid against normal franchise or income taxes. (ss. 70.41 (1), (3) and 70.42 (1), (3), Stats.) (1) Occupational taxes are paid to the treasurer of the town, village or city where the elevator, warehouse or dock of the taxpayer is located on or before December 15th each year. The taxpayer may present his receipt showing payment of such tax to the department of revenue as so much cash in payment of normal franchise or income tax assessed against him in the following year on the tax roll for the same district. If the normal franchise or income tax on this roll exceeds the amount of the occupational tax receipt, only the excess need be paid in cash. All surtaxes must be paid in cash.

(2) If the taxpayer neglects to present his occupational tax receipt at the proper time and pays his entire normal franchise or income tax in cash, he cannot present the receipt at a later date and secure a refund of the normal franchise or income tax paid. A taxpayer cannot tender in payment of an additional normal franchise or income tax assessed at a later date an occupational tax receipt that might have been used had the proper franchise or income tax assessment been made in the first place. If the occupational tax receipt tendered in payment of a normal franchise or income tax exceeds the normal income tax, such excess cannot be applied in payment of additional normal franchise or income tax for the same year assessed at a later date. Occupational tax receipts issued in one taxing district cannot be offset against normal franchise or income tax appearing on the roll for another district.

History: 1-2-56; am. (1), Register, September, 1964, No. 105, eff. 10-1-64; am. Register, March, 1966, No. 123, eff. 4-1-66; am. Register, February, 1975, No. 230, eff. 3-1-75.

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Tax 3.82 Evasion of tax through affiliated interests. (s. 71.11 (7) (a) and (b), Stats.) In administering this section the department of revenue will apply the statute as interpreted by the following cases:

- (1) *Cliffs Chemical Co. v. Tax Commission*, 193 W 295
- (2) *Buick Motor Co. v. Milwaukee*, 43 F (2d) 385
- (3) *Curtis Companies v. Tax Commission*, 314 W 85
- (4) *Palmolive Co. v. Conway*, 37 F (2d) 114; 43 F (2d) 226; 56 F (2d) 83
- (5) *Burroughs Adding Machine Co. v. Tax Commission*, 237 W 423
- (6) *Northern States Power Co. v. Tax Commission*, 237 W 423

Assessment, Abatement and Refund Procedure

Tax 3.83 Domestic international sales corporations (DISCs). (ss. 71.04(4), 71.07(2) and (3), 71.10(1) and (5)(a), 71.11(7) and (7m), 71.20 and 71.22, Stats.) (1) RETURNS. (a) *Franchise/income tax returns.* All domestic international sales corporations (DISCs) having operations in Wisconsin, even though they may have no employees or property in Wisconsin or elsewhere, shall file corporation returns and pay franchise or income tax in the same manner as other corporations. DISCs are accorded no special treatment under chapter 71 of the Wisconsin statutes.

(b) *Consolidated returns.* A DISC may not elect, nor may it be required, to file combined or consolidated returns with its parent or any other entity.

(c) *Due date.* The Wisconsin corporation return (Form 4 or 5) of a DISC is due on or before the 15th day of the 3rd month following the close of its taxable year. If a complete return cannot be filed by the due date, a tentative return may be filed by such date or a 30-day extension may be requested from the department under s. 71.10 (5)(a), Stats., and a tentative return filed before the end of the extension period, to avoid the imposition of late filing penalties. Since the federal annual information return of a DISC is not due before the 15th day of the 9th month following the close of the income year, federal extensions do not apply to a DISC's Wisconsin returns.

(d) *Declarations of estimated tax.* DISCs are subject to the declaration provisions of s. 71.22, Stats.

(e) *Withholding tax.* DISCs shall register and withhold income tax from the wages of their employees under s. 71.20, Stats.

(2) PRICING AND ALLOCATION ADJUSTMENTS. The pricing adjustments provided in s. 71.11 (7), Stats., and the allocation adjustments provided in s. 71.11 (7m), Stats., apply in full to the determination of the net income of a DISC.

(3) DISTRIBUTIONS BY DISCS. The net income of a DISC is not taxable to its corporate shareholders by Wisconsin unless actually distributed as dividends. However, such dividends may be deductible under s. 71.04(4), Stats.

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(4) **COMMISSION DISCS.** The income of a Commission DISC is considered to be income from personal services rather than from sales of tangible property.

(5) **APPORTIONMENT BY THE DISC.** (a) In order for a DISC that has Wisconsin activities to use the apportionment method of filing provided by s. 71.07(2), Stats., it must have net income subject to taxation in at least one other state or foreign country. (See s. Tax 2.39 (2).)

(b) If a DISC qualifies for apportionment, it shall use the statutory 3-factor formula of property, payroll and sales under s. 71.07(2), Stats., unless the use of any factor will give an unreasonable or inequitable final average ratio because such factor is not employed to any appreciable extent in producing the income taxed. In such cases, the department may require or permit the omission of that factor under s. 71.07 (3), Stats.

(c) Beginning with the 1973 taxable year, the payroll factor of a DISC includes deductible management or service fees paid to a related corporation as consideration for the performance of personal services. Such fees are includable in the numerator of the payroll factor, if the services are performed in this state. (See Tax 2.39 (4).)

(d) Beginning with the 1973 taxable year: 1. The sales factor of a buy-sell DISC shall be computed under s. 71.07(2)(c)2, Stats.

2. The sales factor of a commission DISC shall be computed under s. 71.07(2)(c)3, Stats. (See Tax 2.39(5).)

(6) **PARENT CORPORATION'S SALES FACTOR.** When sales are made to a DISC by the DISC's parent corporation, which is permitted to use the apportionment method of computing its Wisconsin net income, and the property sold is shipped from Wisconsin to a customer in a foreign country at the designation of the DISC, such sales are considered to be sales of property shipped to a foreign country which shall not be includable in the numerator of the parent's sales factor. However, if the DISC takes physical possession of the property within Wisconsin and then the property is shipped to a foreign country, the parent shall include such shipments in the numerator of its sales factor.

History: Cr. Register, July, 1978, No. 271, eff. 8-1-78.

Tax 3.91 Petition for redetermination. (ss. 71.10 (13) and 71.12 (1), 71.09(7)(k) and 77.59(6), Stats.) (1) The petition for redetermination specified in ss. 71.12 (1), 71.09 (7) (k) and 77.59 (6), Stats., shall be written, preferably typed, on only one side of plain white paper not more than 8 ½ inches wide by 11 inches long and shall be filed in duplicate. It shall set forth clearly and concisely the specific grievances to the assessment or to parts thereof, including a statement of the relevant facts and propositions of law upon which the grievance is based. Every petition shall be signed by the taxpayer or by a duly authorized representative.

(2) A petition for redetermination is not "filed" within the proper statutory 30-day time period unless it is actually received within the 30-day period, or unless it is mailed in a properly addressed envelope, with postage prepaid, which envelope is postmarked before midnight of the thirtieth day of the month. (See Cr. Register, July, 1987, No. 379)

eth day of the period provided in ss. 71.12 (1), 71.09 (7) (k) and 77.59 (6), Stats.

History: 1-2-56; am. Register, February, 1975, No. 230, eff. 3-1-75; am. Register, July, 1978, No. 271, eff. 8-1-78.

Tax 3.92 Informal conference. The taxpayer may request in its petition, or at any time before the department of revenue has acted thereon, an informal conference at which the facts and issues involved in the assessment or determination may be discussed. Any such conference will be held at a time and place determined by the department.

History: 1-2-56; am. Register, September, 1964, No. 105, eff. 10-1-64; am. Register, February, 1975, No. 230, eff. 3-1-75; am. Register, July, 1978, No. 271, eff. 8-1-78.

Tax 3.93 Closing stipulations. If the informal conference results in an agreement as to facts and issues and the law applicable thereto the taxpayer and the department of revenue may enter into a closing stipulation.

History: 1-2-56; am. Register, September, 1964, No. 105, eff. 10-1-64; am. Register, February, 1975, No. 230, eff. 3-1-75.

Tax 3.94 Claims for refund. (1) Claims for refund may be filed as provided in s. 71.10 (10) or 77.59 (4), Stats., and shall be in the same form as petitions for redetermination under s. Tax 3.91. A claim for refund is not "filed" within the proper time to meet the requirements of ss. 71.10 (10) and 77.59 (4), Stats., unless it is actually in the possession of the department prior to the expiration of the limitation period provided in s. 71.10 (10) or 77.59 (4), Stats., or unless mailed in a properly addressed envelope, with postage prepaid, which envelope is postmarked before midnight of the last day of the limitation period.

(2) Under s. 71.10 (11), Stats., the reduction of income resulting from renegotiation or price redetermination of any defense contract or subcontract is allowable as a deduction from income of the year in which such income was reported for taxation. A claim for refund filed under this subsection must be accompanied by a verified or photographed copy of the renegotiation agreement or price redetermination. No interest is payable on such refund.

(3) When by reason of the allowance of amortization of war facilities over a period shorter than computed in arriving at the original renegotiation adjustment, or for any other reason, a portion of the profits originally determined to be excessive are rebated to the taxpayer by the federal government, such rebate is to be treated as a further renegotiation adjustment, and should be allocated back to the year of the income which was adjusted. Where a refund of Wisconsin income taxes (due to renegotiation) has previously been made, the additional taxes payable by reason of a renegotiation rebate are to be assessed without interest for the reason that such taxes constitute a return to the state of a portion of the previous refund.

History: 1-2-56; am. (1) and (2), Register, September, 1964, No. 105, eff. 10-1-64; am. (1), Register, May, 1966, No. 125, eff. 6-1-66; am. Register, July, 1978, No. 271, eff. 8-1-78.