

DEPARTMENT OF REVENUE

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Chapter Tax 3

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

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Tax 3.01 Rents paid by corporations. (section 71.04 (2), Wis. 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. (section 71.04 (4), Wis. 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 deductible 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 Wis. Adm. Code section Tax 2.04).

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.

Tax 3.05 Profit-sharing distributions by corporations. (section 71.04 (1), Wis. 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. (section 71.04 (1), Wis. Stats.) Bonuses for services actually rendered but not based upon a prearranged bonus agreement or established policy are allowable when actually paid, provided such payments when added to the stipulated salaries or other compensation do not exceed a reasonable compensation for the services rendered. Bonuses paid to employes 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 forms WT-9 or 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. Such adjustments are to be reported on forms WT-9 or 9b.

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

Tax 3.08 Retirement and profit sharing payments by corporations. (section 71.04, Wis. Stats.) (1) Retirement payments to retired officers or employes 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 Wis. Adm. Code sections Tax 2.04 or Tax 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 3.09 Exempt compensation of military personnel. (section 71.01 (3) (f), Wis. 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 section 71.01 (3) (f), Wis. 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 subsection (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 section 71.01 (3) (f), Wis. 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 and federal obligations received by individuals and fiduciaries. (sections 71.05 (1) (a) 1 and 71.05 (1) (b) 1, Wis. Stats.) (1) Interest and dividends, less related expenses, payable on the following types of federal securities shall be subject to the state income tax on individuals and fiduciaries:

(a) Federal Home Loan Bank dividends.

(b) Federal National Mortgage Association certificates. (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.)

(c) Federal National Mortgage Association dividends.

(d) Inter-American Development Bank bonds.

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

(f) International Bank for Reconstruction and Development bonds.

(2) Interest and dividends, less related expenses, payable on the following types of federal securities shall be exempt from the state income tax on individuals and fiduciaries:

(a) Bank for Cooperative debentures.

(b) Farmer's Home Administration insured notes.

(c) Federal Home Loan Bank bonds, debentures and notes.

(d) Federal Housing Authority debentures.

(e) Federal Intermediate Credit Bank debentures.

(f) Federal Land Bank bonds.

(g) Federal Reserve Bank dividends.

(h) Government National Mortgage Association bonds, if payment of such obligations, together with interest thereon, is guaranteed by the United States. (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.)

(i) Production Credit Association debentures.

(j) Small Business Investment Company debentures, if payment of such obligations, together with interest thereon, is guaranteed by the United States.

(k) Tennessee Valley Authority bonds.

(l) Territory of Hawaii bonds.

(m) Territory of Puerto Rico bonds.

(n) United States Postal Service bonds.

(o) United States Savings bonds.

(p) United States Treasury bills and notes.

(3) Interest and dividends, less related expenses, payable on the following types of municipal securities shall be subject to the state income tax on individuals and fiduciaries:

(a) Municipal bonds.

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

(4) Interest and dividends, less related expenses, payable on public housing authority bonds of Wisconsin municipalities shall be exempt from the state income tax on individuals and fiduciaries.

Note: Section 71.05 (1) (a) 1, Wis. 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, Wis. Stats., provides for the exclusion from Wisconsin income of natural persons and fiduciaries of any interest or dividend income, less related expenses, which is by federal law exempt from taxation by Wisconsin.

This rule sets out examples of interest and dividends payable on municipal and federal obligations which are taxable and tax exempt.

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

Tax 3.096 Interest paid on money borrowed to purchase exempt government securities (section 71.05 (1) (b) 1, Wis. 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.

(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. (section 71.05 (1) (b) 4, Wis. 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. (section 71.04 (1), Wis. Stats.) Commissions, lump sum and per diem allowances for travel, entertainment and other expenses, or allowances for use of automobiles, are deductible from gross income, provided that such items are reported on form WT-9 or 9b. Reimbursement of amounts actually expended by officers, employes or others for the benefit of a taxpayer are deductible if it is proven that the amounts thus reimbursed were actually so expended.

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

Tax 3.12 Losses on account of wash sales by corporations. (section 71.04 (7), Wis. 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

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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. (section 71.04 (7), Wis. 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 3.16 Losses by corporations on involuntary conversion. (section 71.04 (7), Wis. Stats.) In all cases of involuntary conversion which result in losses, such losses are deductible in the year in which the conversion takes place.

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

Tax 3.17 Corporation losses, miscellaneous. (section 71.04 (7), Wis. 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.

Tax 3.20 Interest paid by corporations. **History:** 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66; r. Register, September, 1977, No. 261, eff. 10-1-77.

Tax 3.22 Real estate and personal property taxes of corporations. (section 71.04 (3), Wis. Stats.) (1) No accrual for Wisconsin real or personal property taxes may be deducted on any return for a fiscal year ending prior to November 30. Accrual of real or personal property taxes levied in other states is governed by the laws of such states.

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

Tax 3.23 Federal income and excess profits taxes of corporations. **History:** 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66; r. Register, September, 1977, No. 261, eff. 10-1-77.

Tax 3.24 Corporation taxes, miscellaneous. (section 71.04 (3), Wis. 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 3.28 Depreciation, basis for allowance to corporations. **History:** 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66; r. Register, September, 1977, No. 261, eff. 10-1-77.

Tax 3.30 Depreciation and amortization, leasehold improvements; corporations. (section 71.04 (2), Wis. Stats.) (1) Buildings erected on leased land and equipment or improvements permanently attached to leased property, title of which passes to the lessor, the physical life of which is less than the term of the lease, should be written off by the lessee through depreciation charges over the depreciable life of the property, regardless of the term of the lease. In case the life of the property extends beyond the term of the lease, the tax cost of the property normally should be written off over the term of the lease. If a lease is renewed before the end of the amortization period, the lessee must write off the unamortized leasehold improvements as of the date of renewal over the remaining life of the property or the term of the lease, whichever is shorter. In cases in which the lease contains an unexercised option of renewal, the matter of amortizing the tax cost over the term of the original lease plus the renewal period or periods, depends upon the facts in the particular case. When the facts show with reasonable certainty that the lease will be renewed, the tax cost of improvements should be amortized over the term of the original lease plus the term of the renewal period or periods, except in cases where the physical life of the property would be less than such combined terms.

(2) When on termination of the lease the lessor has reported the fair market value of the improvements made by the lessee as taxable income as required by Wis. Adm. Code section Tax 2.80, the lessor is entitled to deduct, beginning with the date of acquisition of title to the improvements, a pro rata amount of depreciation based upon the estimated remaining life of the depreciable property.

History: 1-2-56; am. Register, March, 1966, No. 128, eff. 4-1-66.

Tax 3.31 Depreciation of personal property of corporations. (section 71.04 (15), Wis. Stats.) The depreciation of personal property that is used partly for business and partly for personal purposes, such as automobiles, will be allowed only to the extent that such property is used directly in the production of taxable income.

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

Tax 3.32 Depreciation rates for corporations. **History:** 1-2-56; am. Register, March, 1966, No. 123, eff. 4-1-66; am. Register, February, 1975, No. 230, eff. 3-1-75; r. Register, September, 1977, No. 261, eff. 10-1-77.

Tax 3.35 Depletion, basis for allowance to corporations. (section 71.04 (2), Wis. 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. (section 71.04 (2), Wis. 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. (section 71.04 (2), Wis. 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. (section 71.046) 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 3.42 Amortization of defense facilities—corporations. **History:** 1-2-56; r. and recr. Register, September, 1964, No. 105, eff. 10-1-64; am. Register, March, 1966, No. 123, eff. 4-1-66; r. Register, September, 1977, No. 261, eff. 10-1-77.

Tax 3.43 Amortization of trademark or trade name expenditures—corporations. (Section 71.04 (2e), Wis. Stats.) (1) ELECTION. If a corporation elects to amortize a trademark or trade name expenditure under s. 71.04 (2e), Wis. 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), Wis. 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), Wis. 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. (section 71.04 (7), Wis. 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 section 71.04 (2d) (b) as enacted in chapter 390, laws of 1969, is superseded by section 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. (section 71.04 (2), Wis. Stats.) If bonds are issued at a discount or premium, the net amount of such discount or premium should be amortized over the life of the bonds. 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 such bonds are retired, provided proper adjustment is made for the discount or premium previously reflected in income and in all cases bond expense should 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 must be deducted as current expense in the year that the refinancing takes place and any unamortized premium must be taken up as income in such year.

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