

Chapter Tax 2

INCOME TAXATION, RETURNS, RECORDS AND
GROSS INCOME

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Tax 2.01 Residence. (s. 71.02, Stats.) Individuals claiming a change of residence, i.e., domicile, from Wisconsin to another state shall file form 1-827, "Residence Questionnaire", or the "Residence Questionnaire" which is a part of the 1NPR income tax form, with the Wisconsin department of revenue by attaching it to their Wisconsin income tax return for the year they claim to have changed residence, and shall furnish other information the department may require.

Note: Form 1-827 or form 1NPR may be obtained from the Department of Revenue at 4638 University Avenue, Madison, or from any other Department of Revenue office located throughout the state, or by mail request to Wisconsin Department of Revenue, P.O. Box 8903, Madison, Wisconsin 53708.

History: 1-2-56; r. (1); renum. (2) to be (1); renum. (3) to be (2) and am., Register, September, 1964, No. 105, eff. 10-1-64; am. Register, February, 1975, No. 230, eff. 3-1-75; r. (1), renum. (2) and am., Register, July, 1987, No. 379, eff. 8-1-87; am. Register, February, 1990, No. 410, eff. 3-1-90.

Tax 2.02 Reciprocity. (ss. 71.05 (2) and 71.64 (8), Stats.) (1) PURPOSE. This section explains the reciprocity agreements between Wisconsin and other states.

(2) DEFINITIONS. The following definitions pertain only to Wisconsin. Definitions of the same terms in other states may vary. In this section:

(a) "Personal service income" means all salaries, wages, commissions and fees earned by an employe and all commissions and fees earned by a self-employed person in the conduct of a profession or vocation. Personal service income does not include income derived from activities involving the substantial use of capital or labor of others.

(b) "Resident" means a natural person who is domiciled in this state.

(3) WISCONSIN LAW. (a) Under s. 71.05 (2), Stats., income earned by a nonresident individual for performing personal services in Wisconsin shall be excluded from Wisconsin gross income to the extent the individual's state of residence imposes an income tax on the personal service income, if the state of residence allows:

1. A similar exclusion for personal service income earned by individuals domiciled in Wisconsin while working in that state; or

2. A credit against the tax imposed by that state on the personal service income equal to the Wisconsin tax on the personal service income.

(b) Under s. 71.64 (8), Stats., a Wisconsin employer of a nonresident individual residing in a state with which Wisconsin has a reciprocity agreement under sub. (4) need not withhold Wisconsin income tax from personal service income earned in Wisconsin by the nonresident.

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(4) AGREEMENTS WITH OTHER STATES. (a) Wisconsin has formal reciprocity agreements with:

1. Kentucky: for the years beginning on and after January 1, 1961.
2. Illinois: for the years beginning on and after January 1, 1971.
3. Michigan: for income earned after October 1, 1967 and years beginning on or after January 1, 1968.
4. Minnesota: for the years beginning on and after January 1, 1968.

(b) Wisconsin practices reciprocity with the following states on the basis of informal agreements and acquiescence by Wisconsin and the other state:

1. Indiana: since prior to 1960.
2. Maryland: since prior to 1960.

(5) EFFECT OF RECIPROCITY. (a) Personal service income included under reciprocity agreements is taxed by an employee's state of residence rather than by an employee's state of employment. Wisconsin will not tax personal service income earned in Wisconsin by residents of states with which Wisconsin has reciprocity and those states may not tax personal service income which a Wisconsin resident earns in their states, except as described in subs. (6), (7), (8) and (10).

(b) For personal service income included under reciprocity agreements, an employer need only withhold income tax for the state of residence of an employee.

(c) Federal law regulates withholding on wages earned by employees engaged in interstate transportation activities.

Note: Additional information on withholding on wages earned by employees engaged in interstate transportation activities may be obtained by writing the Wisconsin Department of Revenue, Compliance Bureau, P.O. Box 8902, Madison, Wisconsin 53708.

(6) PROVISIONS OF AGREEMENT WITH ILLINOIS. (a) The reciprocity agreement with Illinois is limited to "wages, salaries, commissions, and any other form of remuneration paid to employees for personal services." However, the agreement does not extend to fees of lawyers, accountants and other self-employed persons deriving personal service income, to lottery winnings, or to persons identified in pars. (c) and (d).

(b) The Illinois Income Tax Act, Article 15, section 1501 (a) (20), defines a resident as "an individual (i) who is in this state for other than a temporary or transitory purpose during the taxable year; or (ii) who is domiciled in this state but is absent from the state for a temporary or transitory purpose during the taxable year". Because of the differences in the definition of resident for Illinois and Wisconsin purposes, a person domiciled in Wisconsin may simultaneously be a resident of Illinois, or a person may be domiciled in Illinois but not be a resident of Illinois.

Example: A person is domiciled in Wisconsin and takes a job in Illinois. The person does not intend to give up his Wisconsin domicile, but instead intends to return to Wisconsin once his job in Illinois is completed (2 to 3 years). Assume that Illinois considers the person's stay in Illinois as other than temporary or transitory. Therefore, the person is a resident of Illinois. The person is also a resident of Wisconsin because he is still domiciled in Wisconsin.

Note: The term "temporary or transitory" as used in the definition of an Illinois resident set forth in sub. (6) (b) is not defined in either Illinois law or regulations. Therefore, whether

or not the purpose for which an individual is in, or is absent from, Illinois is temporary or transitory in character depends upon the facts and circumstances of each particular case.

(c) The reciprocity agreement with Illinois does not apply to any form of compensation described in par. (a) paid on or after January 1, 1974 to any individual who, at the time of payment, is simultaneously a resident of Illinois and a domiciliary of Wisconsin. All income of this person is taxable by Wisconsin. However, a credit against Wisconsin income tax may be claimed for income tax paid to Illinois.

(d) An individual who is domiciled in Illinois but is not a resident of Illinois is subject to the Wisconsin income tax on income earned in Wisconsin.

(7) PROVISIONS OF AGREEMENT WITH MICHIGAN. The reciprocity agreement with Michigan is limited to income from "personal services, including salaries, wages or commissions". The agreement does not include income which Michigan considers to be "business income", such as fees of self-employed persons such as professionals.

(8) PROVISIONS OF AGREEMENTS WITH INDIANA AND KENTUCKY. The reciprocity agreements with the states of Indiana and Kentucky are limited to wages, salaries and commissions.

(9) PROVISIONS OF MARYLAND LAW. Although no formal agreement with Maryland exists, s. 291 of the Maryland statutes is comparable to s. 71.05 (2), Stats., in that a nonresident may exclude from Maryland taxation, the income from salaries, wages and compensation for personal services to the extent the state of residence of the taxpayer taxes income and accords similar treatment to Maryland residents.

(10) PROVISIONS OF AGREEMENT WITH MINNESOTA. (a) The reciprocity agreement with Minnesota is limited to income from personal services, including wages, salaries, tips, fees, commissions, bonuses, or similar earnings, provided the taxpayer personally renders the services. The reciprocity exclusion for personal service income does not apply where the personal or professional service income is earned as a part of a business operated by the taxpayer which has employees that do more than incidental duties for the business, or where there is the sale or delivery of goods which is more than an incidental part of the business. A partner's salary from a partnership where the selling of goods or services of the employees is more than incidental is subject to the reciprocity exclusion, but the partnership profits are not excluded. Distributions from a tax-sheltered annuity are also considered subject to the reciprocity exclusion.

(b) To qualify for the reciprocity exclusion, the Minnesota agreement requires the taxpayer to have a place of abode in Wisconsin, and the taxpayer is required to customarily return to it at least once a month.

(11) PROCEDURE FOR NONRESIDENTS. (a) Nonresident persons, other than residents of Minnesota, employed in Wisconsin and residing in a state with which Wisconsin has reciprocity shall file form W-220, "Nonresident Employee's Withholding Reciprocity Declaration" with their Wisconsin employers to be exempt from withholding of Wisconsin income taxes. Upon receipt of this form, Wisconsin employers may not withhold Wisconsin income tax from Wisconsin personal service income of the employee.

(b) Persons who are residents of Minnesota employed in Wisconsin shall file form W-222, "Statement of Minnesota Residency", with their Wisconsin employers to be exempt from withholding of Wisconsin income taxes. Form W-222 should be filed within 30 days of beginning employment in Wisconsin, changing to a new employer in Wisconsin, or establishing Minnesota residency while continuing to work in Wisconsin. Upon receipt of this form, Wisconsin employers may not withhold Wisconsin income tax from Wisconsin personal service income of the employee. To continue the exemption from year to year, a new form W-222 is required to be filed by January 31 of each year.

(c) The reciprocity exclusion does not apply to Wisconsin lottery winnings of nonresident persons.

(12) PROCEDURE FOR WISCONSIN RESIDENTS. (a) Wisconsin residents employed in a state with which Wisconsin has reciprocity shall file form 1-ES, "Wisconsin Estimated Tax Voucher", with the Wisconsin department of revenue if their out-of-state employers do not withhold Wisconsin income tax from their personal service income and if they will have a sufficient Wisconsin tax liability to be required to make payments of estimated tax.

(b) Wisconsin residents may have their employers cease withholding the other state's income tax from their personal service income and may claim a refund from that state if income taxes are withheld from their personal service income after the effective date of a reciprocity agreement.

(c) Wisconsin residents earning personal service income in states where it is taxable by the other state may claim a credit on their Wisconsin income tax returns for net income taxes paid to these states.

Note: Refer to s. Tax 2.955 for information on the credit for tax paid to other states.

(13) DELINQUENT TAXES. Reciprocity agreements shall not affect the withholding of delinquent Wisconsin income taxes, interest, penalties and costs under s. 71.91 (7), Stats.

Note: Forms 1-ES, W-220 and W-222 and their instructions may be obtained free of charge by writing the Wisconsin Department of Revenue, P.O. Box 8903, Madison, WI 53708.

Out of state employers of Wisconsin residents wishing to withhold Wisconsin income tax from those employee's incomes may contact the department's Compliance Bureau, P.O. Box 8902, Madison, Wisconsin 53708.

History: Cr. Register, April 1978, No. 268, eff. 5-1-78; r. and recr., Register, March, 1991, No. 423, eff. 4-1-91.

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Stats., shall be allowed for the tax sheltered annuity benefits received on or after January 1, 1974 which are included in federal income and upon which the employe previously paid a Wisconsin income tax. The allowable subtraction modification is the amount of deposit on which the Wisconsin tax was previously paid less that portion, if any, of the tax sheltered annuity benefits excludable from Wisconsin income because of receipt prior to January 1, 1974, as illustrated in the following examples which assume that the taxpayer files its tax return on a calendar year basis.

Example 1: An employe made a deposit of \$200 for the purchase of a tax sheltered annuity in 1964, and this amount was included in Wisconsin taxable income. When the employe retires after January 1, 1974, a subtraction modification under section 71.05 (1) (b) 4 is permitted for the first \$200 of tax sheltered annuity benefits received. All subsequent benefits are taxable with no subtraction modification allowed.

Example 2: An employe made a deposit of \$300 for the purchase of a tax sheltered annuity in 1964, and this amount was included in Wisconsin taxable income. The employe retired prior to December 31, 1973, and \$120 of such benefits received were not included in Wisconsin taxable income. A subtraction modification under section 71.05 (1) (b) 4 is permitted for the next \$180 (\$300 - \$120) received after January 1, 1974. All subsequent benefits are taxable with no subtraction modification allowed.

Example 3: An employe made a deposit of \$160 for the purchase of a tax sheltered annuity in 1964, and this amount was included in Wisconsin taxable income. The employe retired prior to December 31, 1973, and treated \$200 of such benefits as nontaxable for Wisconsin income tax purposes. All such benefits received after January 1, 1974 are taxable with no subtraction modification allowed.

History: Cr. Register, April, 1978, No. 268, eff. 5-1-78.

Tax 2.95 Reporting of installment sales by natural persons and fiduciaries. (s. 71.01 (6) and 71.04 (1) (a), Stats.) (1) **GENERAL.** The Wisconsin tax treatment of installment sales by natural persons and fiduciaries is determined under the internal revenue code in effect under s. 71.01 (6), Stats. Installment sales may be made of either real or personal property. Because for Wisconsin purposes, at the time of the sale, the seller may be either a resident or nonresident, and the property may be realty or personalty, tangible or intangible, and may be located within or without Wisconsin, special situations that are not addressed in the internal revenue code may arise which affect the reporting of the sale.

(2) **SITUS OF INCOME.** Under s. 71.04 (1) (a), Stats., all income or loss of resident individuals shall follow the residence of the individual. A nonresident's income or loss derived from the sale of real property or tangible personal property follows the situs of the property. Interest income of a nonresident and income from the sale of intangible personal property follows the individual's residence.

(3) **TAXATION OF PROCEEDS FROM INSTALLMENT SALE OF INTANGIBLE PERSONAL PROPERTY.** (a) *Resident seller.* If the seller is a Wisconsin resident, the portions of each installment payment that represent gain and interest income from the sale which are received while the seller is a resident of this state are taxable by Wisconsin. If the resident seller abandons Wisconsin domicile and establishes residence in another state, neither the gain nor interest payments received while a nonresident is taxable by Wisconsin.

(b) *Nonresident seller.* If the seller is not a Wisconsin resident, the portions of each installment payment that represent gain and interest income from the sale are not taxable by Wisconsin. If the seller subsequently becomes a Wisconsin resident after the sale, the portion of each

installment payment received after becoming a Wisconsin resident representing gain is not taxable by Wisconsin, but the portion representing interest on the installment note is taxable by Wisconsin.

(4) **TAXATION OF PROCEEDS FROM INSTALLMENT SALE OF REAL PROPERTY OR TANGIBLE PERSONAL PROPERTY.** Upon the sale of real property or tangible personal property reported under the installment method:

(a) *Wisconsin property.* 1. If the property is located in Wisconsin and the seller is a Wisconsin resident, the portion of each installment payment that represents gain and interest income from the sale is taxable by Wisconsin.

2. If the property is located in Wisconsin and the seller is not a Wisconsin resident, the portion of each installment payment that represents gain is taxable by Wisconsin. Interest income of a nonresident is *not* taxable by Wisconsin.

(b) *Out-of-state property.* For property located outside Wisconsin which is sold in taxable year 1975 or thereafter:

1. If the sale occurs while the seller is a Wisconsin resident and the seller is a Wisconsin resident at the time installment payments are received, the portions of each of these installment payments that represent gain and interest income from the sale are taxable by Wisconsin. However, if the seller no longer is a Wisconsin resident when installment payments are received, the portions of each of these installment payments that represent gain and interest income from the sale are not taxable by Wisconsin.

2. If the sale occurs while the seller is not a Wisconsin resident and the seller is a Wisconsin resident at the time installment payments are received, the portion of each of the installment payments that represents gain is not taxable by Wisconsin, but interest income from the sale is taxable. However, if the seller is not a Wisconsin resident at the time installment payments are received, the portions of each of these installment payments that represent gain and interest income from the sale are not taxable by Wisconsin.

Note: For taxable years prior to 1975, s. 71.07 (1), Stats., provided that for Wisconsin income taxation purposes, income or loss derived from the sale of real property or tangible personal property followed the situs of the property. Interest income and income or loss from the sale of intangible personal property followed the individual's residence. Therefore, if real property or tangible personal property which was located outside Wisconsin was sold on the installment method prior to taxable year 1975:

1) The portion of each installment payment that represents gain is not taxable by Wisconsin regardless of whether the seller is a resident or nonresident of Wisconsin at the time payments are received, regardless of whether the payments are received in 1975 or in any subsequent year.

2) The portion of each installment payment that represents interest income is taxable by Wisconsin if the seller is a Wisconsin resident at the time payments are received. If the seller is a nonresident of Wisconsin at the time payments are received, the interest portion is not taxable by Wisconsin.

(5) **TAXATION OF PROCEEDS FROM SALE OF INSTALLMENT OBLIGATION.** If the sale of an installment obligation, i.e., an individual's right to unpaid installments from the sale of property, occurs while the seller is a Wisconsin resident, gain or loss on the sale is taxable by Wisconsin. Internal revenue code s. 453B provides that any gain or loss resulting from the disposition of an installment obligation shall be considered as result-

ing from the sale or exchange of the property in respect of which the installment obligation was received. Therefore, if the sale of an installment obligation occurs while the seller is not a Wisconsin resident, gain or loss on the sale is taxable by Wisconsin where the installment obligation resulted from the sale of real property or tangible personal property located in Wisconsin.

Example: In 1987 an Illinois resident sells Wisconsin real estate for \$140,000. The adjusted basis of the property is \$70,000 which results in a gross profit percentage of 50%. The seller receives a down payment of \$40,000 and an installment note of \$100,000 for the balance. In 1988, after receiving a \$60,000 payment on the principal plus interest of \$4,000, the installment obligation was sold for \$45,000. The seller's Wisconsin taxable income from these transactions is as follows:

		Wisconsin Income
1987 - Selling price	\$140,000	
Wisconsin adjusted basis	70,000	
Gross profit	<u>\$ 70,000</u>	
Gross profit percent	50%	
Down payment received	\$ 40,000	
Profit reportable (50% x \$40,000)	20,000	<u>\$ 20,000</u>
Total Wisconsin Income		<u>\$ 20,000</u>
1988 - Payment on principal received	\$ 60,000	
Profit reportable (50% x \$60,000)	30,000	\$ 30,000
Interest received	4,000	-0-
Sale of installment obligation:		
Selling price	45,000	
Less basis - unpaid balance of \$40,000 less unpaid profit due of \$20,000 (50% x \$40,000)	20,000	
Gain on sale of installment obligation (\$45,000 - \$20,000)	25,000	<u>25,000</u>
Total Wisconsin Income		<u>\$ 55,000</u>

History: Cr. Register, January, 1979, No. 277, eff. 2-1-79; r. and recr. (2) and (5) (b) 2.a. and b., am. (4) (a) and (b), (5) (b) 1.a., Register, September, 1983, No. 333, eff. 10-1-83; r. and recr. (1), r. (2), (3) (a), (5) (b) 1. (intro.), a. and b., renum. (3) (b) to be (2) and am., renum. (4) to be (3) and am., renum. (5) (intro.) (a) to be (4) (intro.) (a.), renum. (5) (b) 2. (intro.) a. and b. to be (4) (b) (intro.) 1. and 2. and am., renum. (6) to be (5) and am., Register, March, 1991, No. 423, eff. 4-1-91.

Tax 2.955 Credit for taxes paid to other states. (s. 71.07 (7), Stats.) (1) **DEFINITION.** In this section, "state" means the 50 states of the United States and the District of Columbia, but does not include the commonwealth of Puerto Rico or the several territories organized by Congress.

(2) **CREDITS ALLOWABLE.** (a) Except as provided in sub. (3), an income tax credit may be claimed by a Wisconsin resident individual, estate, or trust for any net minimum tax or income tax paid to another state upon income of the individual, estate or trust taxable by that state.

(b) Except as provided in sub. (3), an income tax credit may be claimed by a Wisconsin resident shareholder in a tax-option (S) corporation for any net minimum tax, income tax, or franchise tax paid by that shareholder to another state on or measured by income of the tax-option (S) corporation.

(3) **CREDITS NOT ALLOWED.** An income tax credit shall not be allowed for:

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(a) Income tax paid to Illinois, Indiana, Kentucky, Maryland, Michigan or Minnesota on personal service income earned in these states included under a reciprocity agreement.

Note: Refer to s. Tax 2.02 for information concerning reciprocity.

(b) Minimum tax or income tax paid to another state on income considered neither taxable income for Wisconsin tax purposes nor a tax preference item in the computation of the Wisconsin minimum tax.

(c) Minimum tax paid to a state which does not classify the minimum tax as an income tax.

(d) Income tax paid to a county, city, village, town or foreign country.

(4) HOW TO CLAIM A CREDIT. The amount of income tax credit claimed shall be entered on the line provided for net income tax paid to other states on Wisconsin income tax return form 1 or form 1NPR. The credit may not exceed the Wisconsin net tax. To support the credit claimed, the following information shall be attached to form 1 or form 1NPR:

(a) For a Wisconsin resident individual, estate, or trust, attach copies of the other state's income tax return and the wage statements, if any, to the Wisconsin income tax return.

(b) For a Wisconsin resident shareholder in a tax-option (S) corporation, the federal subchapter S status of which is recognized by the other state:

1. If a Wisconsin resident shareholder files an individual income tax return with that state, attach a copy of the other state's income tax return to the Wisconsin income tax return.

2. If the corporation files a combined or composite return with that state on behalf of its shareholders who are nonresidents of that state and pays the tax on their proportionate share of the income earned there, attach to the Wisconsin income tax return either a copy of the Wisconsin Schedule 5K-1 on which is shown the shareholder's share of tax paid to that state, or a letter as provided in sub. (4) (d).

3. If the corporation files a corporate income or franchise tax return with that state and pays tax on or measured by income earned there that is attributable to its shareholders who are nonresidents of that state, attach to the Wisconsin income tax return either a copy of the Wisconsin Schedule 5K-1 on which is shown the shareholder's share of tax paid to that state, or a letter as provided in sub. (4) (d).

(c) For a Wisconsin resident shareholder in a tax-option (S) corporation, the federal subchapter S status of which is not recognized by the other state, if the corporation pays an income or franchise tax on or measured by the income earned there, attach to the Wisconsin income tax return either a copy of the Wisconsin Schedule 5K-1 on which is shown the shareholder's share of tax paid to that state, or a letter as provided in par. (d).