

Chapter Tax 3

**INCOME TAXATION, DEDUCTIONS FROM GROSS
INCOME, EXCLUSIONS AND EXEMPTIONS**

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

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

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

(2) **DEFINITION.** "Dividends received" means gross dividends minus taxes on those dividends paid to a foreign nation and claimed as a deduction under ch. 71, Stats.

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

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

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

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

1. Which was subject to the franchise tax in the year preceding the payment of the dividends shall include interest income from the federal government and its instrumentalities.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Register, November, 1993, No. 455

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, and distributions from qualified deferred compensation plans under ss. 401 (k), 403 (b) and 457 of the internal revenue code received by a person while a resident of Wisconsin shall be subject to the Wisconsin income tax, regardless of whether any of these distributions may be attributable to personal services performed outside of Wisconsin.

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

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

Tax 3.095 Income tax status of interest and dividends from municipal, state and federal obligations received by individuals and fiduciaries. (s. 71.05 (6) (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) Asian Development Bank bonds, 22 USC §290i-9.
- (b) College Construction Loan Insurance Association obligations, 20 USC § 1132.
- (c) District of Columbia Development Land Agency bonds, 42 USC § 1452.
- (d) Export-Import Bank of the United States debentures, 12 USC § 635.
- (e) Farmer's Home Administration insured notes, 7 USC §§ 1928 and 1929.
- (f) Federal Assets Financing Trust participation certificates, 12 USC § 1717 (c).
- (g) Federal Financing Bank bonds, 12 USC §2288.
- (h) Federal Home Loan Bank dividends, 12 USC §§ 1426 and 1436.
- (i) Federal Home Loan Mortgage Corporation obligations, 12 USC § 1455.
- (j) Federal National Mortgage Association certificates, 12 USC § 1718.
Note: In 1968, the Federal National Mortgage Association became 2 separate corporations. One corporation retained the original name and the other is known as the Government National Mortgage Association.
- (k) Federal National Mortgage Association dividends, 12 USC § 1719.
- (l) Government National Mortgage Association (Ginnie Mae) bonds, 12 USC §§ 1720 and 1721.
- (m) Insured Merchant Marine bonds, 46 USC § 1273.
- (n) Inter-American Development Bank bonds, 22 USC § 283.
- (o) Interest paid on deposits in any federal bank or agency.

(p) International Bank for Reconstruction and Development bonds, also known as World Bank bonds, 22 USC § 286.

(q) Rural Telephone debentures, 7 USC §947 (a).

(r) Small Business Administration notes, 15 USC §633.

(s) Small Business Investment Company debentures, 15 USC §§ 683 and 687.

(t) Tennessee Valley Authority bonds, 16 USC § 831n-3.

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

(v) World Bank bonds, also known as International Bank for Reconstruction and Development bonds, 22 USC § 286.

(2) Interest and dividends payable on the following federal securities shall be exempt from the 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) Armed Services Housing Mortgage Insurance debentures, 12 USC § 1748b (f).

(b) Bank for Cooperative debentures, 12 USC § 2134.

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

(d) Commodity Credit Corporation bonds, 15 USC §713a-5.

(e) Commonwealth of Puerto Rico public improvement bonds, 48 USC § 745.

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

(g) Federal Deposit Insurance Corporation bonds, 12 USC § 1825.

(h) Federal Farm Credit Banks Consolidated Systemwide Securities, 12 USC § 2055.

(i) Federal Home Loan Bank bonds, debentures, and notes, 12 USC § 1433.

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

(k) Federal Intermediate Credit Bank debentures, 12 USC § 2079.

(l) Federal Land Bank bonds, 12 USC § 2055.

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

(n) Federal Reserve Bank dividends, 12 USC § 531.

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

(p) Financial Assistance Corporation bonds, notes and debentures, 12 USC § 2278b.

(q) Financing Corporation obligations, 12 USC §1441.

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

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

(t) Guam bonds, 48 USC § 1423a.

(u) Industrial Development bonds of East Samoa, 48 USC § 1670.

(v) Production Credit Association debentures, 12 USC § 2098.

(w) Proprietary zero-coupon certificates, 31 USC §3124.

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

(x) Puerto Rico Aqueduct and Sewer Authority revenue bonds, 48 USC § 745.

(y) Puerto Rico Electric Power Authority electric revenue bonds, 48 USC § 745.

(z) Puerto Rico Electric Power Authority power revenue bonds, 48 USC § 745.

(za) Puerto Rico Highway Authority revenue bonds, 48 USC§ 745.

(zb) Puerto Rico Industrial Development Company bonds, 48 USC § 745.

(zc) Puerto Rico Municipal Finance Agency 1974 Series A bonds, 48 USC § 745.

(zd) Puerto Rico Ports Authority revenue bonds, 48 USC § 745.

(ze) Puerto Rico Public Buildings Authority revenue bonds, 48 USC § 745.

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

(zg) Puerto Rico Telephone Authority revenue bonds, 48 USC § 745.

(zh) Puerto Rico Water Resource Authority Series B debentures, 48 USC § 745.

(zi) Student Loan Marketing Association obligations, 20 USC § 1087-2l.

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

(zk) Territory of Hawaii bonds.

(zl) Territory of Puerto Rico bonds, 48 USC § 745.

(zm) United States Postal Service bonds, 39 USC § 2005.

- (zn) United States savings bonds, 31 USC § 3124.
 - (zo) United States Treasury bills and notes, 31 USC § 3124.
 - (zp) University of Puerto Rico university system revenue bonds, 48 USC § 745.
 - (zq) Virgin Islands general obligation bonds, 48 USC §1574 (b) (ii) (A).
 - (zr) Virgin Islands Public Improvement bonds, 48 USC §1574 (b) (i).
- (3) Interest and dividends, less related expenses, payable on the following state, municipal, and other local government securities 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 agency bonds issued after January 28, 1987, and by agencies located outside Wisconsin. Public housing agency bonds issued on or prior to January 28, 1987, by agencies located outside Wisconsin where the interest from the bonds qualifies for exemption from federal income taxation solely because of s. 103 of the internal revenue code. "Public housing agency" as used in this paragraph and in sub. (4) (c) means any state, county, municipality, or other governmental entity or public body, or agency or instrumentality thereof, which is authorized to engage in or assist in the development or operation of lower income housing, under 42 USC § 1437a (b) (6).
 - (d) Virgin Islands Housing Authority bonds issued after January 28, 1987, 48 USC § 1408(a).
 - (e) Wisconsin Health Education Assistance Loan revenue obligation bonds, s. 39.374, Stats.
 - (f) Wisconsin Housing and Economic Development Authority (WHEDA) bonds issued after January 28, 1987, and all business development revenue bonds, economic development revenue bonds, and Community Housing Alternatives Program (CHAP) housing revenue bonds issued by WHEDA, regardless of when issued, ch. 234, Stats.
- (4) Interest and dividends payable on the following state, municipal, and other local government securities shall be exempt from the state income tax on individuals and fiduciaries:
- (a) District of Columbia general obligation bonds issued on or prior to January 28, 1987, where the interest from the bonds qualifies for exemption from federal income taxation for a reason other than or in addition to s. 103 of the internal revenue code.
 - (b) Higher education bonds issued by the state of Wisconsin, s. 71.05 (6) (a) 1, Stats.
 - (c) Public housing agency bonds issued on or prior to January 28, 1987, by agencies, as defined in sub. (3) (c), located outside Wisconsin where the interest from the bonds qualifies for exemption from federal income taxation for a reason other than or in addition to s. 103 of the internal revenue code.

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

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

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

(g) Wisconsin Housing and Economic Development Authority (WHEDA) bonds issued on or prior to January 28, 1987, except business development revenue bonds, economic development revenue bonds and CHAP housing revenue bonds issued by WHEDA.

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

Note: 1) This section lists examples of interest and dividends payable on state, municipal and federal obligations which are taxable and tax exempt.

2) Section 71.05 (6) (a) 1, Stats. (1987-88), previously numbered s. 71.05 (1) (a) 1, Stats. (1985-86), provides for the inclusion in Wisconsin income of natural persons and fiduciaries of any interest, less related expenses, received on state and municipal obligations.

3) Section 71.05 (6) (b) 1, Stats. (1987-88), previously numbered s. 71.05 (1) (b) 1, Stats. (1985-86), 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.

4) 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.*, 96 L Ed 2nd 152, 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.

5) Subsection (4) provides that interest accrued on certain state, municipal and other local government securities issued on or before January 28, 1987, is not subject to Wisconsin income tax. This is due to the fact that no modification is provided for in Wisconsin law that would add to federal adjusted gross income interest from these securities if the interest has been excluded from federal adjusted gross income by any reason other than or in addition to s. 103 of the Internal Revenue Code.

6) 1987 Wis. Act 27 amended s. 71.05 (1) (a) 1, Stats. (1985-86), to provide for the addition to federal adjusted gross income, of any interest not included in federal adjusted gross income which is not specifically exempted from state taxation. This change applies only to securities issued after January 28, 1987. Prior to this act, this addition only applied to interest excluded from federal adjusted gross income solely by s. 103 of the Internal Revenue Code.

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

Tax 3.096 Interest paid on money borrowed to purchase exempt government securities. (s. 71.05 (6) (b) 1, Stats.) (1) Any amount of distributa-

Register, November, 1993, No. 455

ble and nondistributable interest or dividend income which is by federal law exempt from the Wisconsin income tax shall be reduced by any related expense before it is claimed as a subtraction modification on a Wisconsin fiduciary income tax return.

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

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

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

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

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

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

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

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

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

Register, November, 1993, No. 455