through increasing the prices of their product because of the "vagaries of the commodity marketplace." Additionally, this classification serves a legitimate state interest by giving a partial exemption to a valuable part of Wisconsin's economy which has seen a decrease in numbers.

The partnership also argues that the disparate treatment of noncorporate farmers under the recycling surcharge is not a reasonable exemption under §1 of Article VIII of the Wisconsin Constitution. Because Wisconsin farmers serve a vital function in this state as well as throughout the country, because they cannot necessarily recoup the tax through raising the prices on their products, and because farm numbers have dropped, the Court of Appeals concluded that the partial exemption of farmers from the recycling surcharge tax is reasonable.

The Court of Appeals affirmed the Circuit Court's order because it concluded that the tax is not violative of the Equal Protection Clause of the United States Constitution and is a reasonable exemption under §1 of Article VIII of the Wisconsin Constitution.

The partnership has not appealed this decision. □

Tax Releases

"Tax releases" are designed to provide answers to the specific tax questions covered, based on the facts indicated. In situations where the facts vary from those given herein, the answers may not apply. Unless otherwise indicated, tax releases apply for all periods open to adjustment. All references to section numbers are to the Wisconsin Statutes unless otherwise noted.

The following tax releases are included:

INDIVIDUAL INCOME TAXES

1 Adjustments to Interest for Underpayment of Estimated Tax

Statutes: Sections 71.09(1)(am), 71.29(1)(a), 71.84 and 77.947, Wis. Stats. (1993-94)

Note: This tax release applies only with respect to taxable years beginning on or after January 1, 1994.

Background: Individuals, estates, and trusts generally must make estimated tax payments if they expect a tax due (tax, alternative minimum tax, and temporary recycling surcharge, minus credits and withholding) on their return of $200 or more. Partnerships that expect to owe temporary recycling surcharge of $200 or more must make estimated surcharge payments. Corporations, including exempt organizations subject to tax on unrelated business taxable income, that expect the sum of their net tax (tax minus credits) and temporary recycling surcharge to be $500 or more generally must make estimated tax payments. Taxpayers who do not make the required estimated tax payments are subject to interest on the underpayment. [Sections 71.09, 71.29, 71.84, and 77.947, Wis. Stats. (1993-94).]

For taxable years beginning in 1994, the "return" on which the estimated tax requirements are based is a return that would show the tax properly due.

Facts and Question 1: The taxpayer files its 1994 income tax return. The taxpayer did not make the required estimated tax payments throughout the year. The tax return shows a tax due of $4,000 and underpayment interest of $320. The department conducts an audit of the taxpayer's 1994 return and determines that the correct tax due is $5,000. Based on a corrected tax due of $5,000, underpayment interest would be $400. May the department issue an assessment for the additional $80 of underpayment interest ($400 - $320)?

Answer 1: Yes, the department may issue an assessment to the taxpayer for the additional underpayment interest. For taxable years beginning in 1994, underpayment interest is based on a return that would show the tax properly due.

Facts and Question 2: The taxpayer files its 1994 income tax return and pays a tax due of $10,000 and underpayment interest of $800. After the due date of the return, the taxpayer determined it had overreported its income, which resulted in an overpayment of tax of $2,000. Consequently, the correct underpayment interest was $640. The taxpayer filed an amended 1994 return requesting a refund of tax of $2,000 and a refund of $160 of underpayment interest. May the department issue a refund for the underpayment interest?

Answer 2: Yes, the department may refund underpayment interest when a taxpayer's net tax is reduced. This taxpayer would be allowed a refund as follows:

Refund of tax previously paid		$2,000
Refund of underpayment interest previously paid:		
Underpayment interest from original Schedule U	$800	
Underpayment interest from recomputed Schedule U	640	
Difference		160
Amount of refund		$2,160.

Interest would also be paid on the refund of tax ($2,000) at the rate of 9% from the original due date of the return to the date of the refund. Wisconsin law does not provide for interest to be paid on the $160 refund of underpayment interest.

Facts and Question 3: The taxpayer's 1994 income tax return showed a tax due of $1,000; therefore, he makes $1,000 of estimated tax payments for 1995. The taxpayer's 1995 income tax return reports net tax due of $5,000. The taxpayer does not pay any underpayment interest for 1995 because he had made estimated tax payments equal to 100% of his 1994 tax liability. The department conducts an audit of the taxpayer's 1994 return and determines that the correct tax due is $6,000. In addition to assessing additional underpayment interest for 1994, if applicable, may the department assess underpayment interest for 1995?

Answer 3: Yes, the department may assess underpayment interest for 1995. Based on the corrected tax due for 1994, the taxpayer was required to make estimated tax payments for 1995 of $4,500, which is the lesser of 90% of his 1995 tax liability of $5,000 or 100% of his corrected 1994 tax liability of $6,000. Because the taxpayer only made estimated tax payments of $1,000 for 1995, the department may assess underpayment interest. □

2 Exclusion of Capital Gains on Small Business Stock

Statutes: Sections 71.01(10) and 71.05(6)(b)6, Wis. Stats. (1987-88), (1989-90), (1991-92), and (1993-94)

Note: This tax release supersedes the tax release titled "Exclusion of Capital Gains on Small Business Stock" which appeared in *Wisconsin Tax Bulletin* 68 (July 1990), page 15.

Background: Under sec. 71.05(6)(b)6, Wis. Stats. (1987-88), (1989-90), (1991-92), and (1993-94), certain taxpayers may subtract capital gains on "small business stock" from federal adjusted gross income when computing Wisconsin taxable income. The exclusion is available if the taxpayer submits with the Wisconsin income tax return a copy of a certification from the corporation issuing the stock. Section 71.01(10), Wis. Stats. (1987-88), (1989-90), (1991-92), and (1993-94), defines "small business stock" and lists the items that must be included on the certification.

Under sec. 71.01(10), Wis. Stats. (1987-88), (1989-90), (1991-92), and (1993-94), small business stock means an equity security that the taxpayer has held for at least five years and that is issued by a corporation that meets certain requirements as of specific dates and so certifies to the taxpayer. The requirements and applicable dates are specified in sec. 71.01(10).

The small business stock capital gains exclusion was enacted as part of 1985

Wisconsin Act 29, which created secs. 71.02(2)(fr) and 71.05(1)(b)12, Wis. Stats., effective for stock issued to a taxpayer on or after January 1, 1986. Sections 71.02(2)(fr) and 71.05(1)(b)12 were subsequently renumbered secs. 71.01(10) and 71.05(6)(b)6, respectively, effective January 1, 1989.

Question 1: What requirements must be met for stock to be treated as "small business stock" under sec. 71.01(10), Wis. Stats., and what are the applicable dates on which these requirements must be met?

Answer 1: The answer depends on when the stock is issued to the taxpayer. The requirements and applicable dates for meeting the requirements were amended by 1987 Wisconsin Act 27, effective for stock issued on or after August 31, 1987. The requirements were again amended by 1987 Wisconsin Act 399, effective for stock issued in the corporation's taxable year 1988 and thereafter. Following are the requirements and applicable dates for meeting them for the various dates of acquisition.

A. *From January 1, 1986, to August 30, 1987*

For stock issued from January 1, 1986, to August 30, 1987, the requirements that must be met for stock to be treated as small business stock and the applicable dates for meeting these requirements are as follows:

1. At least 50% of the corporation's property and at least 50% of its payroll were in Wisconsin on the December 31 before issuance of the stock.

2. The corporation had no more than 200 employes covered by Wisconsin unemployment insurance, including employes of any corporation that owned more than 50% of the issuing corporation's stock, on the December 31 before issuance of the stock.

3. The corporation derived no more than 25% of its gross receipts from rents, interest, dividends, and sales of assets combined in the calendar year prior to issuance of the stock.

4. The corporation had no stock listed on the New York Stock Exchange, the American Stock Exchange, or the National Association of Securities Dealers' Automated Quotation system on the December 31 before issuance of the stock.

5. The corporation had not conducted a trade or business in corporate or noncorporate form, or a combination thereof, for a period of more than five years prior to the December 31 before issuance of the stock.

6. The corporation had never liquidated its assets in whole or in part for tax purposes only in order to fulfill requirements 1 to 5 above and then reorganized, as of the December 31 before issuance of the stock.

B. *On or After August 31, 1987 — Corporation Incorporated in a Prior Year*

For stock issued on or after August 31, 1987, by a corporation incorporated prior to the calendar year in which the stock is issued, the requirements that must be met for stock to be treated as small business stock and the applicable dates for meeting these requirements are as follows:

1. At least 50% of the corporation's property and at least 50% of its payroll were in Wisconsin on the December 31 before issuance of the stock.

2. The corporation had no more than 500* employes covered by Wisconsin unemployment insurance, including employes of any corporation that owned more than 50% of the issuing corporation's stock, on the December 31 before issuance of the stock.

   * **Note:** For stock issued from August 31, 1987, to the end of the corporation's 1987 taxable year, the number of employes is 200 rather than 500.

3. The corporation derived no more than 25% of its gross receipts from rent, interest, dividends, and sales of intangible investment assets combined in the calendar year prior to issuance of the stock. However, if the corporation had been incorporated for two calendar years or less as of the date the stock is issued and derived less than $3,000 of that type of income during that time, the 25% gross receipts limitation does not apply.

   Example: ABC Corporation, incorporated on March 1, 1985, issues stock to a taxpayer on June 30, 1988. The 25% gross receipts limitation applies to ABC's gross receipts for calendar year 1987. However, if ABC had been incorporated on or after June 30, 1986 (two years or less prior to the issuance of the stock), the 25% gross receipts limitation would not apply if ABC derived less than $3,000 of gross receipts from rents, interest, dividends, and sales of intangible investment assets combined from the date of incorporation to June 30, 1988.

4. The corporation had no stock listed on the New York Stock Exchange, the American Stock Exchange, or the National Association of Securities Dealers' Automated Quotation system on the December 31 before issuance of the stock.

5. The corporation had never liquidated its assets in whole or in part for tax purposes only in order to fulfill requirements 1 to 4 above and then reorganized, as of the December 31 before issuance of the stock.

C. ***On or After August 31, 1987 — Corporation Incorporated During the Year***

For stock issued on or after August 31, 1987, by a corporation incorporated during the calendar year in which the stock is issued, the requirements that must be met for stock to be treated as small business stock and the applicable dates for meeting these requirements are as follows:

1. At least 50% of the corporation's property and at least 50% of its payroll were in Wisconsin on the date the stock was issued.

2. The corporation had no more than 500* employes covered by Wisconsin unemployment insurance, including employes of any corporation that owned more than 50% of the issuing corporation's stock, on the date the stock was issued.

   * **Note:** For stock issued from August 31, 1987, to the end of the corporation's 1987 taxable year, the number of employes is 200 rather than 500.

3. The corporation derived no more than 25% of its gross receipts from rent, interest, dividends, and sales of intangible investment assets combined from the date of incorporation to the date the stock was issued. However, if the corporation derived less than $3,000 of that type of income during that time, the 25% gross receipts limitation does not apply.

   Example: DEF Corporation, incorporated on January 2, 1991, issues stock to a taxpayer on June 30, 1991. The 25% gross receipts limitation applies to DEF's gross receipts from the date of incorporation to June 30, 1991. However, if DEF's gross receipts from rents, interest, dividends, and sales of intangible investment assets combined were less than $3,000 for that time period, the 25% gross receipts limitation does not apply.

4. The corporation had no stock listed on the New York Stock Exchange, the American Stock Exchange, or the National Association of Securities Dealers' Automated Quotation system on the date the stock was issued.

5. The corporation had never liquidated its assets in whole or in part for tax purposes only in order to fulfill requirements 1 to 4 above and then reorganized, as of the date the stock was issued.

Question 2: With respect to stock issued from January 1, 1986, to August 30, 1987 (Part A of Answer 1), how do the requirements apply for a corporation that was not yet incorporated as of the December 31 before issuance of the stock?

Answer 2: Requirements 1, 2, 3, 4, and 6 in Part A of Answer 1 are considered to have been met as of the December 31 before the stock issuance. Only failure to fulfill requirement 5 would preclude stock issued by such a corporation from qualifying as "small business stock."

Question 3: To which year's tax return must the taxpayer attach the certification?

Answer 3: The taxpayer must attach the certification to the tax return on which the capital gains exclusion is claimed. Do not submit the certification with the tax return for the year in which the stock is acquired.

Question 4: To qualify for the capital gains exclusion in sec. 71.05(6)(b)6, must the issuing corporation give the taxpayer the certification required under sec. 71.01(10) at the time of issuance of the stock?

Answer 4: No. However, since the taxpayer must include the certification with the income tax return on which the capital gains exclusion is claimed, the issuing corporation must give the certification to the taxpayer prior to the time for filing that tax return. The Department of Revenue prefers that it be given as soon as reasonably possible after the stock is issued.

Question 5: Is there a form on which the issuing corporation may make the required certification?

Answer 5: No, there is no prescribed form. However, for guidelines concerning the information to include on a certification, refer to the three samples at the end of this tax release. These samples reflect the requirements and applicable dates for meeting them, as described in Answer 1.

The issuing corporation must provide a separate certification for each separate block of stock issued.

[Editor's Note: For purposes of this Bulletin, the samples are on pages 46 to 48.]

Question 6: If a corporation meets the small business stock requirements as of the December 31 before the stock is issued (or as of the date of issuance for stock issued by a new corporation after August 30, 1987) and the corporation so certifies, would the capital gains exclusion continue to apply if the corporation subsequently fails to meet all of the requirements?

Answer 6: Yes. If the corporation meets the requirements as of the applicable dates and so certifies, the fact that the corporation subsequently does not meet one or more of the requirements does not alter the character of the stock as small business stock.

Question 7: What additional requirements must be met for a taxpayer to be entitled to the capital gains exclusion for small business stock?

Answer 7: The capital gains exclusion for small business stock is available only to individuals and fiduciaries who meet certain additional requirements. The eligibility requirements in sec. 71.05(6)(b)6, Wis. Stats., were amended by 1991 Wisconsin Act 39, effective for stock issued on or after August 16, 1991. Following are the eligibility requirements for the various dates of acquisition.

A. ***From January 1, 1986, to August 15, 1991***

For stock issued from January 1, 1986, to August 15, 1991, the eligibility requirements for claiming the capital gains exclusion are as follows:

The capital gains exclusion applies only to the person who initially acquired the stock from the corporation. The stock must be issued directly by the corporation to the person claiming the capital gains exclusion. It cannot be acquired from a secondary source, such as through a purchase from a shareholder of a corporation, rather than from the corporation itself.

The taxpayer's stock acquisition from the corporation may be by purchase or it may be by some other means, such as a stock dividend, a stock split, or a stock-for-stock exchange; however, the acquisition may not be by gift.

B. ***On or After August 16, 1991***

For stock issued on or after August 16, 1991, the eligibility requirements for claiming the capital gains exclusion are as follows:

The capital gains exclusion applies only to the original purchaser of small business stock that is purchased at the time that the business is incorporated. The stock must be purchased from the corporation. It may not be acquired by some other means such as a stock dividend, stock split, stock-for-stock exchange, or gift. The stock cannot be acquired from a secondary source, such as through a purchase from a shareholder of a corporation, rather than from the corporation itself.

The stock must be shares that were authorized and issued as part of the initial stock offering during the incorporation process. Shares subsequently purchased from the corporation do not qualify for the capital gains exclusion even though the shares were authorized in the original articles of incorporation.

Question 8: Does the capital gains exclusion for small business stock apply with respect to stock issued as a stock dividend? (**Note:** A stock dividend is a capitalization of earnings or profits, together with a distribution of the added shares which evidence the assets transferred to capital.)

Answer 8: The answer depends on when the stock is issued, illustrated as follows:

A. ***From January 1, 1986, to August 15, 1991***

Stock issued as a stock dividend from January 1, 1986, to August 15, 1991, may qualify as small business stock if the corporation meets the requirements under sec. 71.01(10), Wis. Stats., as of the December 31 prior to issuance of the stock (assuming the corporation was incorporated in a year prior to the issuance of the stock).

Since the stock is not acquired by gift, the capital gains exclusion applies, provided the taxpayer holds the stock for at least five years and submits the certification with the tax return on which the capital gain is reported.

Example 1: Prior to 1986, Taxpayer Z acquired 100 shares of GHI Corporation stock that do not qualify as small business stock. GHI declared a stock dividend and, on September 1, 1988, issued one-quarter of a share of stock for each share owned by the shareholders. Therefore, Taxpayer Z received an additional 25 shares. GHI met the small business stock requirements as of December 31, 1987, and so certified to each shareholder.

Since Taxpayer Z did not acquire the 25 shares of GHI stock issued on September 1, 1988, by gift, he may claim the small business stock capital gains exclusion for these 25 shares, provided he holds them until September 1, 1993, and submits the certification with the tax return on which the capital gain is reported. Taxpayer Z's original 100 shares of GHI stock do not qualify for the small business stock capital gains exclusion.

Example 2: On June 15, 1988, Taxpayer Y acquired 100 shares of JKL Corporation stock that do not qualify as small business stock. JKL declared a stock dividend and, on February 1, 1990, issued one-half of a share of stock for each share owned by the shareholders. Therefore, Taxpayer Y received an additional 50 shares. JKL met the small business stock requirements as of December 31, 1989, and so certified to each shareholder.

Since Taxpayer Y did not acquire the 50 shares of JKL stock issued on February 1, 1990, by gift, she may claim the small business stock capital gains exclusion for