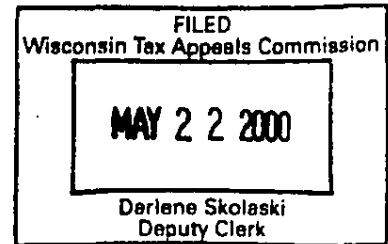
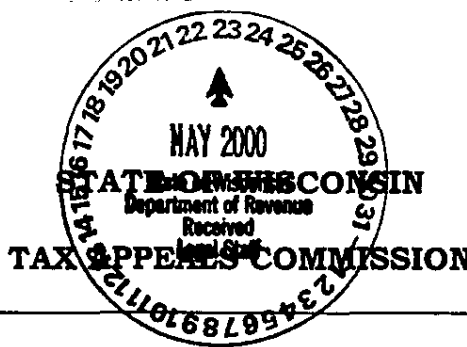


1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28  
29  
30  
31  
32  
33  
34  
35  
36  
37  
38  
39  
40  
41  
42  
43  
44  
45  
46  
47  
48  
49  
50  
51  
52  
53  
54  
55  
56  
57  
58  
59  
60  
61  
62  
63  
64  
65  
66  
67  
68  
69  
70  
71  
72  
73  
74  
75  
76  
77  
78  
79  
80  
81  
82  
83  
84  
85  
86  
87  
88  
89  
90  
91  
92  
93  
94  
95  
96  
97  
98  
99  
100

BORGE MICHAEL BETTY 99I37 052200 TAC



**MICHAEL AND BETTY C. BORGE** \*

P.O. Box 42  
Cambridge, WI 53523

Petitioners, \*

vs. \*

**WISCONSIN DEPARTMENT OF REVENUE** \*

P.O. Box 8933  
Madison, WI 53708

Respondent. \*

DOCKET NO. 99-I-37

**RULING AND ORDER**

**AWARDING**

**SUMMARY JUDGMENT**

---

**MARK E. MUSOLF, CHAIRPERSON:**

This matter is before us on the respondent's motion for summary judgment pursuant to Wis. Stat. § 802.08. Both parties have filed briefs with affidavits in support of their positions. Michael Borge represents the petitioners. Attorney Sheree Robertson represents the respondent.

Having considered the entire record, the Commission hereby finds, concludes, and orders as follows:

**UNDISPUTED MATERIAL FACTS**

1. Petitioners jointly filed Wisconsin income tax returns as residents of Wisconsin for the years 1993 through 1996 ("years in issue").

2. On petitioners' Wisconsin income tax returns for the years in issue, they reported state and municipal bond interest received from individual

state and municipal bonds owned by them. On those same returns, petitioners excluded from their income certain dividend distributions ("the disputed distributions") received from mutual funds investing solely in federally tax-exempt state and/or municipal bonds. The amounts of the disputed distributions received by petitioners were \$28,667 in 1993, \$22,431 in 1994, \$20,018 in 1995, and \$21,447 in 1996.

3. Under date of February 23, 1998, respondent adjusted petitioners' Wisconsin income tax returns for the years at issue because it determined that petitioners were not entitled to exclude the disputed distributions from their income because they constituted state and municipal bond interest received from the mutual funds in those years.

4. Respondent determined that the additional municipal bond interest petitioners received which was subject to Wisconsin income tax was \$28,667 in 1993, \$22,431 in 1994, \$20,018 in 1995, and \$21,447 in 1996.

5. Petitioners filed a letter of objection, dated April 21, 1998, which respondent considered their petition for redetermination. In the objection, petitioners argued that the disputed distributions are not "interest" within the meaning of Wis. Stat. § 71.05(6)(a)1 and are, therefore, not subject to Wisconsin income tax.

6. Respondent issued to petitioners its notice of action letter, dated January 21, 1999, denying their petition for redetermination on grounds that the disputed distributions retain their character as state and municipal

interest when passed as dividends to the shareholders of a mutual fund and are, therefore, included in Wisconsin adjusted gross income under Wis. Stat. § 71.05(6)(a).

### APPLICABLE STATUTE

#### 71.05 Income computation.

\* \* \*

(6) MODIFICATIONS AND TRANSITIONAL ADJUSTMENTS. Some of the modifications referred to in s. 71.01(13) and (14) are:

(a) *Additions.* To federal adjusted gross income add:

1. The amount of any interest, except interest under par. (b) 1., less related expenses, which is not included in federal adjusted gross income, and except the amount of any interest or original issue discount derived from bonds issued under subch. IV of ch. 18.

### APPLICABLE INTERNAL REVENUE CODE

Sec. 852 [1986 Code].

\* \* \*

(b) METHOD OF TAXATION OF [REGULATED INVESTMENT] COMPANIES AND SHAREHOLDERS.—

\* \* \*

(5) EXEMPT-INTEREST DIVIDENDS.—If, at the close of each quarter of its taxable year, at least 50 percent of the value (as defined in section 851(c)(4)) of the total assets of the regulated investment company consists of obligations described in section 103(a), such company shall be qualified to pay exempt-interest dividends, as defined herein, to its shareholders.

\* \* \*

(B) TREATMENT OF EXEMPT-INTEREST DIVIDENDS BY SHAREHOLDERS.—An exempt-interest dividend shall be treated by the shareholders for all purposes of this subtitle as an item of interest excludable from gross income under section 103(a). Such purposes include but are not limited to —

(i) the determination of gross income and taxable income.

\* \* \*

## CONCLUSIONS OF LAW

1. There is no genuine issue as to any material fact, and summary judgment is therefore appropriate under Wis. Stat. § 802.08.

2. The respondent properly determined that dividend distributions received by petitioners from mutual funds investing solely in obligations whose interest is subject to Wisconsin income tax are includible in Wisconsin adjusted gross income as "interest," pursuant to Wis. Stat. § 71.05(6)(a)1.

## OPINION

Petitioners maintain that the dividends they received from various mutual funds are not "interest" within the meaning of Wis. Stat. § 71.05(6)(a) even though they were derived from such interest received by the funds. They argue that these "dividends" cannot be "interest" because the mutual funds are not contractually obligated to pay "interest" to their shareholders. Therefore, petitioners insist, because § 71.05(6)(a) does not specifically include federally tax-exempt mutual fund dividends as an addition for Wisconsin adjusted gross income, the Department's assessment is without statutory authority.

The Department relies on language in a federal tax publication<sup>1</sup>, as well as the holding in *Capital Preservation Fund, Inc. v. Department of Revenue*, 145 Wis. 2d 841 (Ct. App. 1988). That case affirmed the Circuit Court's determination that a money dividend derived from a mutual fund's investments

---

<sup>1</sup> Publication 17, *Your Federal Income Tax* (1990).

in federal obligations “retains its character as tax exempt income (on a state level) when the [mutual fund] distributes it to shareholders and investors...” *Capital Preservation Fund, Inc. v. Wisconsin Department of Revenue*, No. 86-CV-1385 at p. 15 (Wis. Cir. Ct. Dane County May 11, 1987).

Although the Department urges us to apply this “retains its character” holding by analogy to a mutual fund’s dividends that are *exempt* from federal taxation, we decline to do so because, as explained below, specific statutory grounds exist for including such dividends in Wisconsin income.

In the parlance of the Internal Revenue Code, a mutual fund is a “Regulated Investment Company” (“RIC”). I.R.C. § 851. The taxation of RICs and their shareholders is controlled by I.R.C. § 852. Specifically, I.R.C. § 852(b)(5)(B), *supra*, provides that an exempt-interest dividend shall be treated by an RIC shareholder “as an item of interest excludable from gross income” for federal tax purposes, including the determination of taxable income.<sup>2</sup>

Thus, the disputed distributions received by petitioners, which they insist are dividends rather than “interest,” are expressly required by I.R.C. § 852(b)(5)(B) to be treated by petitioners as “interest”. Accordingly, because the disputed distributions are required to be treated as excludable “interest” for federal income tax purposes, Wis. Stat. § 71.05(6)(a)1 requires that they be added back in determining Wisconsin adjusted gross income because they are

---

<sup>2</sup> This Internal Revenue Code provision is likely the source of the language in *Your Federal Income Tax* (1996), cited by the Department.

"interest ...which is not included in federal adjusted gross income...."  
Accordingly, we conclude that the Department's determination was proper.

Because specific Internal Revenue Code and Wisconsin statutory provisions apply to petitioners' case, we need not determine if the holding in *Capital Preservation Fund, Inc.* applies by analogy here. That case involved the applicability of 31 U.S.C. § 3124(a)<sup>3</sup> to interest on direct U.S. obligations, taxable federally, which Wisconsin also sought to tax when distributed to taxpayers as dividends through a mutual fund. The Wisconsin Court of Appeals applied § 3124(a) to the dividends, rejecting the Department's position that they were taxable.

#### ORDER

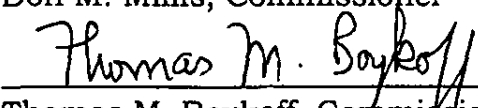
The respondent's action on petitioners' petition for redetermination is affirmed.

Dated at Madison, Wisconsin, this 22nd day of May, 2000.

#### WISCONSIN TAX APPEALS COMMISSION

  
\_\_\_\_\_  
Mark E. Musolf, Chairperson

  
\_\_\_\_\_  
Don M. Millis, Commissioner

  
\_\_\_\_\_  
Thomas M. Boykoff, Commissioner

ATTACHMENT: "NOTICE OF APPEAL INFORMATION"

<sup>3</sup> "[O]bligations of the United States Government are exempt from [State] taxation."