Taxation - Basis and Gain or Loss

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TAXATION—BASIS AND GAIN OR LOSS

The basic concepts of income under the Wisconsin Income Tax Act are not different than those of the Federal law. The statutory language of each is almost identical in setting forth the sources of taxable income. The Wisconsin law having been enacted in 1911, no income is taxable which is properly attributable to a period prior to that date. Thus, in an early case it was held that where stock was purchased in 1907 and had an appreciated value in 1911, the appreciation was not taxable when realized upon a sale in 1914.

The basic formula for gain or loss in sales or dispositions of property under Wisconsin Tax law is the excess of the amount realized over the cost of acquisition in the case of gain, and the excess of the cost over the amount realized in the case of loss. That same fundamental rule governs under the Internal Revenue Code. While it will not be considered at this time, it could be noted that both systems provide for adjustment of the cost basis because of additions to or reductions from capital.

In line with the rule that no income is taxable which is properly attributable to a period prior to 1911, the Wisconsin Statute declares that in determining gain or loss from the sale or other disposition of property acquired prior to 1911, the basis shall be the fair market value at that date. It is significant to point out that for purposes of gain the statute comes into play only when there is an actual economic gain, i.e., where the amount realized exceeds the cost of acquisition. The statute, however, says that there will be taxable gain only to the extent that the amount realized exceeds the fair market value at Jan. 1, 1911. The mere fact that the amount realized exceeds the 1911 fair market value will not give rise to income unless the amount realized also exceeds the cost. Thus, where stock was purchased prior to 1911 for $471,000 and depreciated in value at 1911 to $92,000, and was subsequently sold for $131,000, no table gain resulted. And so in applying this statute to compute gain or loss, it should be kept in mind that the first thing to be determined is whether there is any economic gain or loss under the basic cost formula. If there is, then the 1911 value can be applied to

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1 State ex rel. Bolens v. Frear, 148 Wis. 456, 134 N.W. 673 (1912); State ex rel. Arpin v. Eberhardt, 158 Wis. 20, 147 N.W. 1016 (1914); State ex rel. Bundy v. Nygaard, 163 Wis. 307, 158 N.W. 87 (1916); State ex rel. Wisconsin Trust Co. and others v. Widule, 164 Wis. 56, 159 N.W. 630 (1916); Westby v. Bekkedal 172, Wis. 114, 178 N.W. 451 (1920).
2 I.R.C. Sec. 22(a) ; Wis. Stats. 71.03(1) 1949.
4 Falk v. Wisconsin Tax Commission, 201 Wis. 292, 230 N.W. 64 (1930).
5 I.R.C. Sec. 111.
6 Wis. Stats. 71.03 (1) (9) 1949.
ascertain the taxable gain or the amount of deduction allowable for a loss.

Passing from purchase acquisitions to acquisitions by gift, we find in the Wisconsin Statute some substantial departures from the rules for gain and loss as set forth by the Internal Revenue Code. For purposes of the Federal tax, when property is acquired by gift after Dec. 31, 1920, the basis for determining gain on a sale or other disposition is the same as it was in the hands of the donor or last preceding owner who did not acquire it by gift. And the rule is the same in cases of loss except that if the cost basis of such prior owner exceeds the fair market value at the time of the gift then the basis is the fair market value. A gift acquired during the period from 1922 to July 31, 1943, is treated in Wisconsin as having the basis of the last preceding owner who did not acquire it by gift.

It should be emphasized that the statute makes no provision for the application of the fair market value instead of the cost of the prior owner with respect to gifts acquired during the 1922-1943 period when a loss is sustained as does the Federal code. Notwithstanding the absence of any reference to fair market value in this portion of the statute, the Wisconsin court has indicated in a recent case that fair market value is to be considered. There the donee was given some stock in 1936 which had no value at the date of the gift. Later the stock was cancelled in a reorganization of the corporation and the donee attempted to take a loss. The statute requires the donee to sustain a loss upon a sale, and the court held that the cancellation did not amount to a "sale" within the meaning of the statute. That holding would have been sufficient to prevent the donee from taking a loss. But the court went on, making this assumption:

"Had he made a sale (bonafide) there would be occasion for comparing the results of his sale with the cost of the property to the last owner not acquiring it by gift as against comparing the returns on the sale with the value of the stock when acquired by the donee."

Apparently the court feels that the fair market value is a factor for consideration in determining losses. But again the statute does not refer to fair market value of property acquired by gift during the 1922-1943 period.

It is interesting to observe that the statute provides that for property acquired by gift after July 31, 1943, the basis for determining gain or loss shall be the fair market value of the valuation for gift tax purposes. Now it would seem that if the legislature expressly made the

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8 I.R.C. Sec. 113 (a) (2).
9 Ibid.
10 Wis. Stats. 71.03 (1) (9).
fair market value the basis for one period, it did not also intend that fair market value should also be applied for the prior period, especially when it used express language to the contrary.

In *Appeal of Siesel*, a result was reached which is significant when the gift is of property located outside Wisconsin. In 1930 a donor in Pennsylvania made a gift of stock, having a basis of $22 per share, to a Wisconsin donee. At the time of the gift, the stock was worth $78 per share. The donee then sold it for $78. Though the donee’s basis would be $22 under the statute discussed above, it was held that there was no income to the donee for the reason that the appreciation in the value of the stock occurred outside Wisconsin, and for that reason, not taxable in Wisconsin. From the taxpayer’s standpoint this seems almost too good to be true. Indeed, it indicates a simple method of liberating appreciations of value from property by merely making gifts across state lines with the only tax being a gift tax by the donor.

In reading the Wisconsin statute it will be noted that a gap exists as to gifts acquired between 1911 and 1922. No basis provision is made. The question is no doubt open to argument as to what the basis shall be for such gifts. The writer feels that the fair market value is probably the answer in view of the Federal provision that the basis for gifts prior to January 1, 1921 is the fair market value.

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12 *Appeal of Siesel*, 217 Wis. 661, 259 N.W. 839 (1935).