REPORT ON LITIGATION

This portion of the WTB summarizes recent significant Tax Appeals Commission and Wisconsin court decisions. The last paragraph of each decision indicates whether the case has been appealed to a higher court.

The last paragraph of each WTAC decision in which the department's determination has been reversed will indicate one of the following: 1) "the department appealed", 2) "the department has not appealed but has filed a notice of nonacquiescence" or 3) "the department has not appealed" (in this case the department has acquiesced to Commission's decision).

The following decisions are included:

Individual Income Taxes

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INDIVIDUAL INCOME TAXES

Sarah G. Barber vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, December 20, 1984). The sole issue for the Commission to determine is whether a custodial parent may claim an itemized deduction for child care expenses if the non-custodial parent is entitled to claim the child as a personal exemption on his or her income tax return, and if the non-custodial parent provided more than $600.00 per year in child support.

In January, 1977, the taxpayer was granted a judgment of divorce from her husband, Michael Barber, in which she was awarded physical custody of their infant daughter, Magdalene. The divorce judgment required Michael Barber to make child support payments to the taxpayer for his daughter and allowed him to claim her on his income tax return as a dependent child exemption.

During 1978, 1979 and 1980, Michael Barber was current in his child support payments which, each year, exceeded $600.00.

During 1978 through 1980, the taxpayer claimed an itemized deduction on her Wisconsin individual income tax return for child care expenses incurred in caring for Magdalene while she was employed. The taxpayer did not claim her child as a dependent personal exemption on her income tax returns for any of these years. The department disallowed the taxpayer's child care expense deduction for each of the years 1978, 1979 and 1980 since she was not entitled to the exemption for her child.

The Commission concluded that the taxpayer may not deduct child care expenses incurred during the years 1978, 1979 and 1980 when her exhusband, by divorce decree, is entitled to claim this child as a personal exemption and when he has provided at least $600.00 per year for the support of said child.

The taxpayer has appealed this decision to the Circuit Court.

Henry L. Eickelberg vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, October 19, 1984). The issues for the Commission to determine are (a) whether the taxpayer resided in Kansas from April 1, 1981 to August 15, 1981 and, therefore, did not reside in Wisconsin during that period within the meaning of s. 71.01(1), Wis. Stats.; (b) whether the excess of the fair market value of the stock the taxpayer received, over the amount he paid, upon his exercise of a "non-qualified" stock option on January 2, 1981, was income to him at that time within the meaning of Section 83(a), IRC; and (c) whether the Tax Appeals Commission has jurisdiction to consider the taxpayer's claim that he is entitled to the exception to the imposition of the penalty for the underpayment of estimated tax.

During the period 1964 to 1974, the taxpayer and his wife lived in their home near Watertown, Wisconsin. In 1974, the taxpayer took a position with Sauder Industries, Inc. in Emporia, Kansas, and established his residence there. His wife remained at their home near Watertown and worked in Milwaukee.

On August 31, 1979, the taxpayer relinquished his position as vice president and general manager at Sauder Industries, Inc. and moved back to Wisconsin. He continued to be employed by Sauder Industries, Inc. working out of his home.

On April 1, 1981, the taxpayer was temporarily called back to Emporia by Sauder due to the dismissal of his replacement as vice president and general manager. The taxpayer stayed in Kansas until August 15, 1981, when a new vice president and general manager took over the position. Before going to Kansas, the taxpayer had advised Sauder that he planned on retiring in September 1981. Sauder paid for the taxpayer's semi-furnished apartment in which he stayed while in Kansas. He retained his Wisconsin voting registration, and his Wisconsin driver's license and automobile license plates. After August 15, 1981, the taxpayer returned to his home near Watertown and continued working for

Sauder at least through the end of 1981.

Effective January 2, 1981, the taxpayer exercised his option under the terms of the Alaska Interstate Company Non-Qualified Stock Option to purchase 3,700 shares of Alaska Interstate's stock for $29,365.63. On that date, he received stock in Alaska Interstate with a fair market value of $117,365.63 or $88,000 in excess of the amount paid. At the time the options were granted to the taxpayer by Alaska Interstate, they did not have a readily ascertainable fair market value and he did not pay income tax on the value of the options.

On April 5, 1982, the taxpayer prepared a Wisconsin income tax return, which he subsequently filed with the department, in which he declared that in 1981 he was a full year resident of Wisconsin. He also reported as taxable income the $88,000 excess value of the stock he received over what he paid for it.

On May 18, 1982, the taxpayer was sent a notice of penalty for underpayment of estimated tax in the amount of $368.76. On June 2, 1982, he filed a petition for redetermination, which was denied by the department. The taxpayer did not file a petition for review with the Commission. While his challenge to the penalty was pending, the taxpayer filed an amended 1981 Wisconsin income tax return. In the amended return, he claimed that he was not a resident of Wisconsin from April 1, 1981 to August 15, 1981 and that he sold 1,700 shares of Alaska Interstate on April 13, 1981. He claimed that wages received while working in Kansas and other income received while a resident of Kansas, including the gain on the sale of Alaska Interstate stock sold on April 13, 1981, was not includable in Wisconsin taxable income in 1981.

The Commission held that during the period under review, the taxpayer was domiciled and resided at Rural Route 4, Watertown, Wisconsin. The excess of the fair market value of the stock he received, over the amount he paid, upon his exercise of a "non-qualified" stock option on January 2, 1981, was income to him at that time within the meaning of Section 83(a), IRC. The Tax Appeals Commission does not have jurisdiction to consider the taxpayer's claim that he is entitled to the exception to the imposition of the penalty for the underpayment of estimated tax.

The taxpayer has appealed this decision to the Circuit Court.

James L. and Gladys A. Landphier vs. Wisconsin Department of Revenue (Circuit Court of Dane County, December 13, 1984). The taxpayers petitioned the Court for review of a decision by the Wisconsin Tax Appeals Commission dated February 26, 1982. The Commission upheld a determination by the department that income from property and lifetime services assigned by the Landphiers to a family trust was taxable to them as individuals for the years 1974 through 1976.

James Landphier was employed as a truck driver for Motor Transport Company, while Gladys Landphier worked as a bookkeeper for Virchow Krause and Company and operated a freelance bookkeeping business. On October 31, 1972, James Landphier established a trust. The trust instrument designated Mr. Landphier as the grantor-creator and named Gladys Landphier and Hattie M. Derr (Mrs. Landphier's mother) as trustees and acceptors. Approximately two weeks later, Ms. Derr resigned her position as trustee, and was replaced by James Landphier.

Gladys Landphier conveyed to her husband certain of her real and personal properties, including the use of her lifetime services and all currently earned income. Mr. Landphier conveyed these properties, together with certain of his real and personal properties, the exclusive use of his lifetime services and all currently earned income, to the trust.

The trust instrument did not technically name any beneficiaries, but instead was divided into 100 units of "beneficial interest". The taxpayers' two children each held 35 units, Mr. Landphier held 10 units and Mrs. Landphier held 20 units. Despite this apportionment, the taxpayers exercised virtually unchecked power over the trust.

As executive manager and secretary of the trust, Mr. and Mrs. Landphier received various benefits from the trust in exchange for their administrative services. These benefits included the receipt of consultant's fees and the payment of costs associated with the taxpayers' housing, transportation, educational, travel, health care and insurance expenses. Only the taxpayers, in their capacities as trustees, were authorized to withdraw funds and write checks from the trust's bank account.

The Circuit Court ruled that because the Landphiers did not sufficiently relinquish control of the assets that they transferred to the trust, they are properly taxable for the income from those assets.

The issue of whether the taxpayers are now entitled to deductions on their individual returns for the years 1974 through 1976 and in what amounts is remanded to the Commission for further proceedings.

The taxpayers have not appealed this decision.

Thomas J. and Kathleen M. Meronek vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, October 19, 1984). The issue for the Commission to determine is whether or not the automobile travel expense by the taxpayer from her home to her place of employment was a proper deduction for Wisconsin income tax purposes.

Kathleen M. Meronek was employed by Reedsburg Memorial Hospital, Reedsburg, Wisconsin since 1976. As part of her employment contract, she was "on call" for emergency medical purposes, and she was subject to call any time of any day. She kept records of the travel expenses from her house to her place of employment at the hospital for "on call" trips only, which averaged three days a week. The taxpayer did not receive any reimbursement for the miles she drove from her home to her place of employment for her "on call" trips.

The taxpayers had an office audit regarding the years under review in 1982 at which they disclosed to the Wisconsin Department of Revenue how they took the travel expenses. The department, by letter dated November 30, 1982, stated: "On the basis of the information which you submitted, no adjustments will be made at this time."

On March 29, 1983, the taxpayers received a letter which requested them to substantiate their mileage deductions for work. This letter was the beginning of a field audit against them. Because of the field audit, Kathleen M. Meronek was denied her deduction for automobile travel expenses

that she claimed from her home to her place of employment for "on call" purposes.

The Commission concluded that Kathleen M. Meronek is not allowed to deduct automobile mileage from her home to her place of employment for "on call" requests by her employer. The department's prior office audit did not bar the department's subsequent field audit assessment.

The taxpayers have not appealed this decision.

CORPORATION FRANCHISE/INCOME TAXES

Jantzen, Inc. vs. Wisconsin Department of Revenue (Wisconsin Department of Revenue, October 19, 1984). During the period 1973 through 1978, Jantzen, Inc. was a Nevada corporation with its principal offices in Portland, Oregon. Jantzen manufactures sportswear and other wearing apparel and sells such apparel to retailers throughout the United States. The issue for the Commission to determine is whether the maintenance and operation of a sales office and showroom in Milwaukee, Wisconsin by the taxpayer or its sales representatives is doing business in Wisconsin within the meaning of s. 71.01(2), Wis. Stats., in excess of the solicitation of orders within the meaning of Section 381(a)(1), United States Code.

Jantzen, Inc. employed two resident sales representatives who had an office in Milwaukee from which they conducted business. The duties of the two sales representatives included calling on retail stores and preparing customer orders for the purchase of Jantzen's products. They had sales areas which included almost all of the State of Wisconsin and the Upper Peninsula of the State of Michigan. Jantzen, Inc. leaves it up to the sales representative whether or not he or she wants to lease an office, with the understanding that the sales representative must pay for the expenses of the office.

The taxpayer's sales representatives sent orders they obtained from retailers in Wisconsin and the Upper Peninsula of Michigan to Portland, Oregon for approval or rejection, and if approved by Jantzen, Inc., were filled by shipment or delivery from points outside Wisconsin.

During the period under review, Jantzen, Inc. employed Stanley Larsen and James G. MacDonald as sales representatives, who shared expenses of an office located at 161 West Wisconsin Avenue in Milwaukee, Wisconsin. Each of them had a showroom in which they displayed samples of sportswear and other wearing apparel sold by the taxpayer. They also employed a part-time secretary to answer the telephone and type orders. The taxpayer charged the cost of the samples against the sales representatives' commissions and the sales representatives sold the samples to customers to recoup the expense. In 1964 the office at 161 West Wisconsin Avenue was leased by "C. Stanley Larsen and Perry M. Bowerman d/b/a Jantzen, Inc." During the period from 1970 through 1978 seven extensions of the lease and two riders were executed by "C. Stanley Larsen d/b/a Jantzen, Inc."

During the period November 1973 through November 1977, the telephone directory for the Milwaukee area contained a listing for Jantzen, Inc., with one number for the Women's Division and one for the Men's Division, and with the 161 West Wisconsin Avenue street address. The name "Jantzen" is listed on the downstairs directory to the building and on the door to the leased office space. The name "Jantzen" appears in the office on one or two posters, on catalogs, and on sample merchandise. The letterhead used by Mr. Larsen and Mr. MacDonald contains Jantzen's registered trademark consisting of the name "Jantzen" and a small figure diving through the "n".

The Commission held that during the period under review, Jantzen, Inc.'s maintenance and operation of a sales office and showroom in Milwaukee, Wisconsin constitutes doing business in Wisconsin within the meaning of s. 71.01(2), Wis. Stats., in excess of the solicitation of orders within the meaning of Section 381(a)(1), United States Code. Therefore, the taxpayer is subject to Wisconsin's franchise tax.

The taxpayer has not appealed this decision.

Kar Products, Inc. vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, November 27, 1984). During the period under review, Kar Products, Inc. was a Delaware corporation with principal offices in Des Plaines, Illinois. The taxpayer was in the business of selling maintenance repair items to such businesses as truck fleets, automotive companies, construction companies, and industrial plants. The taxpayer's two catalogues listed in excess of 30,000 separate items, ranging from nuts and bolts, to tools and brushes, to industrial solvents and cleaners, to machines and equipment.

The principal issue in this case is whether the activities of Kar Products' salesmen in Wisconsin constituted doing business within the State of Wisconsin for purposes of the corporate franchise and income tax, or whether they were activities that constituted exempt solicitation of sales under Public Law 86-272. The taxpayer also objects to the imposition of the negligence penalty, the addition to tax for underpayment of estimated tax, and the delinquent interest because Kar Products had reasonable cause not to file returns.

The taxpayer sold its products in approximately 45 of the 48 continental United States. The sales activity was generally carried out through independent contractors or salesmen, who were compensated by commission. Kar Products' Wisconsin sales averaged about three percent of its total sales volume for tax fiscal years ending November 30, 1973 through December 31, 1981.

The taxpayer's distribution network employed district sales managers, zone managers, and outside salesmen. The Wisconsin sales territory included one sales district. Each individual salesman was known as an "area manager" and had a particular sales territory assigned to him by contract. A senior salesman known as a "zone manager" was assigned to oversee several junior salesmen in addition to performing his own sales duties. A district manager was assigned to oversee the entire sales district. The district sales manager hired and fired as well as helped salesmen keep records on sales activity in the district.

During its tax years 1973 through 1981, Kar Products employed an average of nine Wisconsin salesmen. Orders received by the salesmen were shipped out of the Des Plaines,

Illinois headquarters. The salesmen's regular activities included delivering and setting up bins, stocking and labelling bins, picking up and returning merchandise, picking up payments, calling on and collecting delinquent accounts, and issuing credit memos to adjust accounts.

The Commission concluded that during the period under review, Kar Products, Inc. engaged in numerous business activities in the State of Wisconsin that exceeded the intent and meaning of the boundaries of solicitation as defined in Public Law 86-272. The taxpayer's business activities in the State of Wisconsin constituted doing business in Wisconsin within the meaning of s. 71.01(2), Wis. Stats., in excess of the solicitation of orders within the meaning of Section 381(a)(1), United States Code. Therefore, the taxpayer is subject to Wisconsin's franchise tax.

The Commission also concluded that the taxpayer failed to provide reasonable cause to abate the negligence penalty within the intent and meaning of s. 71.11(46), Wis. Stats. Kar Products, Inc. should have filed declarations of estimated franchise tax and proper Wisconsin franchise tax returns at the end of their business year; therefore, the Commission lacks jurisdiction to waive any delinquent interest or filing fees for the years under review.

The taxpayer has appealed this decision to the Circuit Court.

Payco Seeds, Inc. vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, November 27, 1984). During the period 1973 through 1979, Payco Seeds, Inc. was a Minnesota corporation with its principal offices in Dassel, Minnesota, and was engaged in the raising and selling of hybrid seed corn. It neither owned any real property nor maintained an office in Wisconsin. The issue for the Commission to determine is whether the business activities of the taxpayer or its sales representatives constituted doing business in Wisconsin, within the meaning of s. 71.01(2), Wis. Stats., in excess of the solicitation of orders within the meaning of Section 381(a)(1), 15 United States Code.

Payco Seeds, Inc. employed two resident sales representatives who conducted business from their own offices in Wisconsin. The duties of the two sales representatives included calling on seed dealers and preparing orders for the purchase of the taxpayer's products. They were not independent contractors. They did not have written contracts of employment with Payco Seeds, Inc., but only oral agreements. They were paid a base salary, plus commissions on their sales and those of their dealers; and they paid their own business expenses (although the taxpayer made some reimbursement).

The sales representatives sent the orders they obtained from seed dealers in Wisconsin to Dassel, Minnesota, for approval or rejection. If approved by the taxpayer, they were filled by shipment or delivery from Dassel, Minnesota.

The sales representatives stocked and sometimes sold the taxpayer's seeds, but were not at risk for its spoilage or other loss. They delivered the taxpayer's seeds to dealers or dealers' customers, and transferred seeds between dealers. They picked up obsolete or damaged seeds for the taxpayer. They helped prepare dealers' "settlement sheets", obtained credit references for the taxpayer, accepted payments, and adjusted and collected accounts for the taxpayer.

The Commission concluded that during the period under review, Payco Seeds, Inc.'s sales of seeds to Wisconsin dealers through Wisconsin salesmen constituted doing business in Wisconsin within the meaning of s. 71.01(2), Wis. Stats., in excess of the solicitation of orders within the meaning of Section 381(a)(1), United States Code; and therefore, the taxpayer is subject to Wisconsin's franchise tax.

The taxpayer has appealed this decision to the Circuit Court.

Regency Nursing Home, Inc., d/b/a Riverside Hills Nursing Home vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, November 13, 1984). The issue for the Commission to determine is whether income from the taxpayer's sale of its nursing home facility and business is "income attributable to the operation of a trade or business regularly carried on by the taxpayer" within the meaning of s. 71.06, Wis. Stats. 1973.

Regency Nursing Home, Inc. was a Wisconsin corporation with its principal offices at 222 Erie Street, Milwaukee, Wisconsin. The taxpayer was incorporated in 1962, and from 1971 through November 27, 1974 was engaged solely in the business of operating a nursing home. As an integral part of this business, the taxpayer owned the land, building, and related personal property ("the nursing home facility") on and in which the nursing home business operated. The operation of the nursing home business consisted of using the nursing home facility for the care of its patients who lived there and were treated there and caring for and treating these patients.

Based on its lack of business experience in this area, the taxpayer and its affiliates felt that it was not suited to own such a business and operate it successfully. The nursing home facility and business were sold on November 27, 1974 (fiscal 1975) and the realized gain was $289,101.94.

The taxpayer was not in the business of buying and selling nursing home facilities and businesses or tangible personal property.

On its Wisconsin corporate income tax return for the fiscal year ending August 31, 1975, the taxpayer carried forward losses from the previous fiscal years, an aggregate of $193,701.25, and offset these losses (which are net business losses within the meaning of s. 71.06, Wis. Stats. 1974) against the gain realized on the sale of the nursing home facility and business.

After the sale, the taxpayer's assets were distributed to its shareholder between the date of the closing of the sale and May 21, 1976, at which time the taxpayer was dissolved.

The Commission concluded that the income Regency Nursing Home, Inc., d/b/a Riverside Hills Nursing Home, received from the gain on the sale of its nursing home facilities and business on November 27, 1974 was not income attributed to the operations of a trade or business regularly carried on by the taxpayer within the intent and meaning of s. 71.06, Wis. Stats. The taxpayer's gain on the sale of its business assets may not be reduced by the net business loss offset.

This Commission is without authority to review any matter not raised in the taxpayer's petition for redetermination under s. 71.12, Wis. Stats., and therefore lacks jurisdiction to decide the subsidiary issues raised by the

taxpayer in its amended petition for review.

The taxpayer has appealed this decision to the Circuit Court.

W.R. Grace & Company vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, February 12, 1985.) The taxpayer is a publicly-owned Connecticut corporation, with its corporate headquarters located in New York, New York. The taxpayer is a multi-national conglomerate with over 70,000 employes worldwide.

The issues raised by the taxpayer in this case are as follows:

A. Is the taxpayer entitled to use separate accounting in determining its Wisconsin taxable income for the year 1975 under the provisions of s. 71.07(2), Wis. Stats.?

B. If the Commission determines that the taxpayer is not entitled to report by the separate accounting method, did the department erroneously include the unrelated dividends and the unrelated Jacques Borel International gain in the taxpayer's apportionable income for the year 1975?

C. If the Commission determines that the taxpayer is subject to apportionment and that the department was correct in including the taxpayer's dividend and capital gain income in the taxpayer's apportionable base, should the taxpayer be allowed factor relief under s. 71.07(5), Wis. Stats., to partially minimize any distortion which may be the result of the department's method?

D. If the Commission determines that the department was correct in including the unrelated dividends and the unrelated foreign gain in the apportionable base, should gains realized before the July 31, 1975 effective date of the amendment to the statute and the pre-1975 earnings included in the dividend income be removed from the tax base to avoid impermissible retroactive taxation?

Grace conducts its domestic operations through 60 unincorporated, separate profit units. The company's domestic operations were merged into the company for convenience purposes, rather than having a lot of small subsidiaries. The company's foreign operations are conducted through foreign subsidiaries, incorporated in the countries in which they are located in order to ensure compliance with each country's laws, rules, customs and practices.

The taxpayer's business operations have developed primarily by acquisitions of companies. Since 1945, the taxpayer has acquired approximately 130 businesses. The taxpayer has sold approximately 60 of its businesses since 1960.

Grace's chemical operations are the mainstay of the company's business, with growing interests in natural resources and in consumer products and services. Its overall operations encompass many diverse fields, including chocolate, appliances, apparel, cattle, fertilizer, racing components, construction products, chemicals, rubber, fabrics, footwear, electric products and seafood. As a result of 25 years of deliberate emphasis upon what the taxpayer regards as its principal area of competence, 82% of its earnings came from chemical products and processes.

The taxpayer's profit units are integrated with other units, if they are related in function. For example, various chemical operations would be functionally organized into one division. The company's domestic operations are organized primarily into five major divisions, as follows: (1) Agricultural Chemicals (fertilizers, animal feed and artificial insemination); (2) Retail Goods (home improvements, sporting goods, western clothing and other clothing); (3) Restaurants; (4) Industrial Chemicals; and (5) Natural Resources.

Several units, such as Ambrosia Chocolate Company ("Ambrosia"), do not fit into one of these larger divisions. Ambrosia is organizationally placed with another chocolate company in the Netherlands, forming a cocoa division in New York.

Each division (or functionally integrated group of profit units) has a regional headquarters in one or more locations. For example, the agricultural chemicals group, consisting of several units, has its headquarters in Memphis, Tennessee. The manager of American Breeders Service ("ABS") reports to the head of the Memphis office. The manager of Ambrosia reports to the head of the cocoa division in New York. The heads of these divisions are responsible for the hiring and firing of the top management person at each profit unit within that division, but the New York office has the final say in the hiring of a top person in a profit unit. The top management person in each division reports to the company's New York home office.

Of the taxpayer's 60 profit units, 33 had some activity within Wisconsin during 1975. These 33 units had total Wisconsin sales of $41,573,000. The taxpayer's total sales in 1975 were $1,759,951,740.

The company has been headed by J. Peter Grace, Jr., grandson of the company's founder, since 1945. He has exercised a strong influence over the taxpayer's operations throughout his tenure.

The taxpayer's basic policy concerning acquisitions is to seek out, analyze and study businesses and their management, which in the opinion of the taxpayer's top management are the type of businesses that the company should be in. In looking at a company for acquisition, the taxpayer's top managers seek one with competent management because they want to bring the company in with its existing management to run its day to day operations. In keeping with this policy, the New York office does not tell the units how to run their business operations, provided the operations continue to run well and to provide a fair and reasonable return to the company's shareholders.

The principal function of the taxpayer's top corporate management is to decide which businesses the company should be in, to channel the shareholders' investment capital into these businesses, and to insure that the individual businesses selected are capably managed.

The managers of the profit units are responsible for the day to day operations of their businesses. Each unit operates independently, handling its own advertising, purchasing and public relations. Each unit is responsible for paying its own expenses and payroll and for keeping its own books and records.

The New York office employs 700 to 800 people. The operations of the New York office are divided into six groups: (1) Corporate Administrative Group which has responsibility for