

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 non-acquiescence" or (3) "the department has not appealed" (in this case the department has acquiesced to Commission's decision).

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INDIVIDUAL INCOME TAXES

Constitutionality of taxes. *Edward J. Beuth vs. Wisconsin Department of Revenue* (Court of Appeals, District I,

May 23, 1986). Edward Beuth appealed from the trial court's judgment affirming a Wisconsin Tax Appeals Commission decision.

The taxpayer filed an unsigned 1982 state tax return that reported no income. The Wisconsin Department of Revenue assessed \$1,773 in income tax against him. Beuth contends that because the department had no jurisdiction to tax him, the Circuit Court erred in affirming the assessment. He claims that the department does not have the authority to tax "natural persons" and that once he challenged the assessment, the department was required to prove its jurisdiction over him. Beuth further argues that he was denied due process because the department deprived him of property without notice and opportunity to be heard and because he did not have a jury trial. Finally, in support of his claim that the department may not tax him, Beuth makes an unintelligible fifth amendment argument.

The Court of Appeals affirmed the judgment of the Circuit Court.

The taxpayer has not appealed this decision.

Basis of assets. *Wendy L. LaBadie vs. Wisconsin Department of Revenue* (Court of Appeals, District I, August 22, 1986). Wendy L. LaBadie appealed an order affirming a decision and order of the Wisconsin Tax Appeals Commission. (See WTB 42 and 46 for a summary of the Wisconsin Tax Appeals Commission and Circuit Court decisions.)

The sole issue is whether the trial court and the Commission erred in affirming the department's refusal to refund LaBadie's claimed overpayment of income taxes on capital gains from the sale of commercial stock shares that appreciated during a period she was not a resident of Wisconsin.

The Court of Appeals reasoned that LaBadie's alleged "gain" on her stock during the period of her nonresidency was fictitious. It is true that her stock did accrue some gain while LaBadie was a nonresident. However, this gain was not

realized, and hence was not subject to taxation, until the stock was sold. LaBadie sold the stock upon regaining her Wisconsin residency. Because she realized gain on the stock sale while she was a resident, the department could properly tax that gain.

The Court of Appeals affirmed the order of the Circuit Court affirming the department and the Commission.

The taxpayer appealed this decision to the Supreme Court. The Supreme Court denied the taxpayer's petition for review.

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Pensions. *Harold G. Wines vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, August 27, 1986). The issues to be decided by the Wisconsin Tax Appeals Commission were as follows:

- A. Whether the pension payments that the taxpayer received from the First Wisconsin Trust Company's pension fund in 1982 are to be included in his gross income as provided for in s. 71.03(2)(d), Wis. Stats.
- B. Whether the Wisconsin Tax Appeals Commission has authority to determine s. 71.03(2)(d), Wis. Stats., is constitutional.

The taxpayer retired from the First Wisconsin Trust Company on August 31, 1969. Upon his retirement, the taxpayer began receiving monthly pension checks from the First Wisconsin Trust Company's pension fund, and the taxpayer had received the checks each month since his retirement. The taxpayer was a member of the Wisconsin Trust Company's pension plan before December 31, 1963, and had a vested interest in it before that date.

The taxpayer timely filed a Wisconsin resident individual income tax return for himself and his wife for the 1982 income year with the department. Included in the gross income shown on the taxpayer's 1982 income tax return was his pension from the First Wisconsin Trust Company in the amount of \$6,443. On March 8, 1985, the taxpayer prepared an amended income tax return for 1982 and filed it with the Wisconsin Department

of Revenue. The taxpayer's amended 1982 return showed a refund of \$365 due to him. The amount of refund claimed resulted from the taxpayer's exclusion from his taxable income of his First Wisconsin Trust Company pension of \$6,443.

The Commission concluded that all income received by a Wisconsin resident is subject to taxation unless specifically exempted by statute. There is no exemption provided in the Wisconsin Statutes which exempts from income taxation the pension the taxpayer received in 1982 from the First Wisconsin Trust Company. Statutes enacted by the legislature are deemed to be constitutional until declared otherwise by a court of competent jurisdiction. The Commission is a quasi-judicial state agency, not a court of competent jurisdiction and does not have the jurisdiction to rule on constitutional issues.

The taxpayer has not appealed this decision.

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CORPORATION FRANCHISE/INCOME TAXES

Installment sales. *Castle Corporation vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, August 27, 1986). The issue for determination by the Commission is whether the installment method of reporting is allowed for Wisconsin tax purposes on the taxpayer's 1982 sale of farmland.

The taxpayer acquired certain farmland, 126 acres more or less, on September 19, 1980, for which its cost or other basis was \$250,433.34. The taxpayer sold that parcel of real estate on February 4, 1982 for a selling price of \$744,072 (corrected from the reported \$750,000 by stipulation of the parties). The taxpayer computed its gain on the installment method in the amount of \$184,117.35. The taxpayer received payments during the year 1982 of \$274,802.40. The payments received were payments on principal, exclusive of interest payments.

The department disallowed the taxpayer's deferral of \$319,349.31 stating that the

installment method of reporting the gain on the sale of assets is allowed only if the payments received in the year of sale do not exceed 30% of the selling price, citing Wis. Adm. Code Tax 2.19.

The Commission concluded that long-standing, formally promulgated administrative rules have the effect of law and must be enforced by the Commission. Tax 2.19 is such a rule. The taxpayer was not entitled to the installment method in reporting the gain it received in 1982 from the sale of its real estate because it received more than 30% of the selling price in the year of sale. The department acted properly in disallowing the taxpayer's deferral of \$319,349.31.

The taxpayer has appealed this decision to the Circuit Court.

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Business loss carryforward. *Wisconsin Department of Revenue vs. McHenry Sand & Gravel Co., Inc.* (Circuit Court of Dane County, July 29, 1986). The issue in this case arose from an appeal from a hearing at which the Wisconsin Tax Appeals Commission determined that the department erroneously disallowed a loss carryforward on a franchise tax assessment against the taxpayer. At issue is whether Wisconsin law admits of any distinction between loss carryforwards involving mergers of multiple corporations and loss carryforwards involving mergers of single corporations.

In March 1976, the stockholders of the Illinois corporation, McHenry Sand & Gravel, voted to form a subsidiary corporation, Charles S & G Merging Corporation, for purposes of forming a Delaware corporation. At the first meeting of the Charles S & G Merging Corporation, it was voted to merge the Illinois corporation, McHenry Sand & Gravel, into the Delaware corporation. Charles S & G Merging Corporation was renamed McHenry Sand & Gravel, a Delaware corporation. McHenry Sand & Gravel, an Illinois corporation, ceased to do business as of March 29, 1976. In May 1976, all stockholders of McHenry Sand & Gravel, an Illinois corporation, exchanged all stock held in the Illinois corporation for stock in McHenry Sand & Gravel, a Delaware corporation. All

stockholders in the Illinois corporation continued to be stockholders in the Delaware corporation. The board of directors and officers of the Illinois corporation immediately prior to merger were the same as those of the Delaware corporation immediately following the merger. The merging of the Illinois corporation with the Delaware corporation was the legally necessary means to obtain a more favorable tax climate than existed in Illinois.

In November 1981, the department issued an assessment denying the taxpayer a net business loss carryforward for its fiscal years 1978 and 1979, based on a loss sustained by its predecessor Illinois corporation in fiscal 1974. The Commission reversed the department's assessment against the taxpayer, thus allowing the loss carryforward.

The Circuit Court found that the Commission's decision constitutes an error of law. Therefore, the Circuit Court ordered that the decision of the Wisconsin Tax Appeals Commission is reversed. The taxpayer is denied a net business loss carryforward for its fiscal years 1978 and 1979.

The taxpayer has not appealed this decision.

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Wives' travel expense. *Spacesaver Corporation vs. Wisconsin Department of Revenue* (Circuit Court of Jefferson County, May 8, 1986). Spacesaver Corporation appealed from an order of the Wisconsin Tax Appeals Commission dated February 12, 1985 affirming the department's action disallowing deductions for the expenses of wives attending Spacesaver sponsored sales conventions in calendar years 1977 through 1981. (See WTB 42 for a summary of the Tax Appeals Commission's decision.)

The only issue before the Circuit Court was whether the taxpayer may deduct as ordinary and necessary business expenses the expenses for wives of employees of the taxpayer who attended the taxpayer's national sales conferences in light of s. 71.04(2)(a), Wis. Stats.

The taxpayer is a Wisconsin corporation with principal offices in Fort Atkinson,

Wisconsin. The company manufactures and sells high density storage, a system of movable shelves that maximizes utilization of file storage space. Most of Spacesaver's sales are made through franchised area contractors in the United States and Canada. Most of the franchisees are small businesses with family members involved in the business. The taxpayer holds sales conferences annually, with Spacesaver personnel and certain wives acting as hosts. As many franchisees and wives as possible are invited to attend the meetings, and franchisees have an obligation to attend. The company cultivates an atmosphere that treats the contractor and his wife as a unit because the company believes with good reason that rapport between spouses is essential to a productive business.

The meetings are two and a half day affairs. Wives participate mostly in social and vacation type activities, although wives of Spacesaver personnel assist with other facets of the convention. The latter assistance appears incidental to the primary role of entertaining contractors' wives at fashion shows and sightseeing tours. Although the taxpayer insists wives are not there to vacation, their roles appear to be more vacation oriented, or so the Commission found, and so it could have found from the evidence presented.

The Circuit Court affirmed the decision of the Commission.

The taxpayer has appealed this decision to the Court of Appeals.

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SALES/USE TAXES

Appeals — Petition for review. *Foley & Lardner vs. Wisconsin Department of Revenue* (Court of Appeals, District IV, July 24, 1986). Foley & Lardner appealed a judgment affirming a Wisconsin Tax Appeals Commission order dismissing its petition for review. The issue is whether the Commission erred in concluding that Foley & Lardner did not file a petition for redetermination of the Wisconsin Department of Revenue's denial of its claim for refund.

The taxpayer filed a claim for refund with the department for sales taxes paid.

It contends that on September 18, 1984, the department stated that the claim was denied. The department sent forms to the taxpayer so that it could file corrected reports for the period in question. The taxpayer mailed the corrected reports to the department on October 8, 1984. On October 30, 1984, the department wrote the taxpayer that its refund claim was denied and stated that the taxpayer could file a written objection within sixty days of receipt of the letter. The taxpayer filed a petition for review with the Tax Appeals Commission on December 20, 1984.

The taxpayer argues that either its October 8, 1984, letter accompanying the completed forms, or its petition for review filed with the Tax Appeals Commission, is a petition for redetermination.

The Court of Appeals concluded that the Commission's decision had a rational basis, and therefore affirmed that decision.

The taxpayer has not appealed this decision.

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Construction contractors — exempt entity construction. *Hayward Community School District and Vonasek & Schieffer, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, August 27, 1986). This matter was before the Commission on a remand order dated July 1, 1986 from Dane County Circuit Court.

On or about July 10, 1980, the Hayward Community School District (HCSD) entered into a contract with Vonasek & Schieffer, Inc. (V&S) as general contractors to build a new Hayward High School. V&S agreed that all material to be used in construction of the Hayward High School would be purchased in compliance with the purchase procedure mandated by HCSD. HCSD did not utilize a purchase process under which purchase orders and payments would be directly issued by the school district because it lacked the specific expertise necessary to make the purchases. The purchase orders for materials to build the school were issued by V&S and not HCSD.

On October 5, 1982, the department issued a determination of sales and use tax due to V&S with respect to materials purchased for the Hayward High School. The taxpayers maintain that an agency relationship existed between HCSD and V&S, thus entitling V&S to the exemption from tax contained in s. 77.54(9a), Wis. Stats.

The Commission concluded Vonasek & Schieffer, Inc., not Hayward Community School District, was the builder or construction contractor for the Hayward High School and is not entitled to the exemption from tax afforded school districts contained in s. 77.54(9a), Wis. Stats. The construction contract entered into between Vonasek & Schieffer and Hayward Community School District and its implementation did not create an agency relationship which would allow application of the exemption contained in s. 77.54(9a), Wis. Stats. Vonasek & Schieffer, Inc., was the consumer of the materials it purchased to build the Hayward High School. Sales of building materials to contractors or subcontractors used in the construction of buildings or structures or the alteration, repair or improvement of real property for exempt entities are subject to tax.

The taxpayer has appealed this decision to the Circuit Court.

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Successor liability. *Gregory L. Vallee vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, August 27, 1986). The issue for determination by the Commission is whether the taxpayer had successor liability as a purchaser of certain business equipment of Egg Plant, Inc. for unpaid sales tax under provisions of s. 77.52(18), Wis. Stats.

The business known as Egg Plant, Inc. (a/k/a Dragonwood Pub & Cafe) was given an offer to purchase under date of February 16, 1983, by Gregory L. Vallee for the purchase of the tavern and restaurant business at 305 West Johnson Street, Madison, Wisconsin. The seller, Egg Plant, Inc., under date of February 16, 1983, submitted a counter-offer to the taxpayer for the purchase of business assets and the business opportunity known as the Egg Plant, Inc., a/k/a

Dragonwood Pub & Cafe, which was accepted by the taxpayer. On April 13, 1983, the seller, Egg Plant, Inc., and the buyer, Gregory L. Vallee, closed the transaction and the taxpayer purchased the business assets of the seller, Egg Plant, Inc., pursuant to the closing statement and inventory taken by the buyer as of April 12, 1983.

On April 5, 1983, Gregory L. Vallee, as owner of the Dragonwood Pub & Cafe, applied for a Wisconsin Department of Revenue seller's permit. The department issued seller's permit number 354010 to the taxpayer on April 6, 1983 for said business.

On September 9, 1983, the former owner, Egg Plant, Inc., was issued an assess-

ment of additional sales and use tax for the period May 1982 through February 1983 by the department based upon information furnished to the department by the former owner. On April 13, 1984, the former owner of the business Egg Plant, Inc. was issued a notice of assessment of additional sales and use tax for April 1983 regarding the sale of the business assets to the taxpayer. Gregory L. Vallee, purchaser, and the seller, Egg Plant, Inc., did not request a clearance certificate pursuant to s. 77.52(18), Wis. Stats.

The Commission concluded Gregory L. Vallee was successor to the seller's business under s. 77.52(18), Wis. Stats., and s. Tax 11.91(1)(a), Wis. Adm. Code. At the time of sale of the business to the

taxpayer, the seller was liable for unpaid sales tax for the period under review. Not having received from the seller a receipt from the department that all amounts of sales tax had been paid, or a certificate stating that no amount was due pursuant to s. 77.52(18), Wis. Stats., the taxpayer's failure to withhold from the purchase price an amount sufficient to cover this liability renders him liable for that amount. The department is not estopped from assessing such tax.

The taxpayer has not appealed this decision.

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TAX RELEASES

("Tax Releases" are designed to provide answers to the specific tax questions covered, based on the facts indicated. However, the answer may not apply to all questions of a similar nature. In situations where the facts vary from those given herein, it is recommended that advice be sought from the Department. 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. Interest Income from Bonds Issued by Wisconsin Housing Finance Authority (p. 10)
2. Reinvestment of Condemnation Awards (p. 10)
3. Wisconsin Net Operating Loss Carryover (p. 11)

Corporation Franchise/Income Taxes

1. Payroll Factor - Section 401(k) Earnings (p. 12)

Sales/Use Taxes

1. Animal Bedding Purchased by Farmers (p. 13)
2. Claim for Refund of Sales and Use Tax (p. 13)
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Farmland Preservation Credit

1. Farmland Credit - Dairy Termination and Conservation Reserve (p. 15)
2. Gross Farm Profits Requirement (p. 15)

INDIVIDUAL INCOME TAXES

1. Interest Income Received from Bonds Issued by the Wisconsin Housing Finance Authority

Statutes: Section 71.05(1)(a)1, 1985 Wis. Stats.

Note: This Tax Release supercedes the Tax Release published in Wisconsin Tax Bulletin 32 titled "Is Interest Income Received from Bonds Issued by the Wisconsin Housing Finance Authority Taxable?"

Facts and Question: Is interest income which an individual receives from bonds issued by the Wisconsin Housing Finance Authority excludable from his or her Wisconsin taxable income.

Answer: Yes. Federal law (42 U.S.C.) provides that interest income received from an obligation of a Housing Authority is exempt from federal income tax. Because this interest is not included in the federal adjusted gross income starting point used for Wisconsin tax purposes, it is not included in Wisconsin taxable income unless an add modification is provided for in the Wisconsin Statutes. The only add modification Wisconsin law provides in regard to interest is one that pertains to interest income excluded from federal income under section 103 of the Internal Revenue Code (IRC). Interest income received from a Housing Authority is not excluded from federal income under IRC section 103.

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2. Reinvestment of Condemnation Award

Statutes: Section 71.02(2), 1983 Wis. Stats.

Facts and Question: Section 1033 of the federal Internal Revenue Code allows for postponement of recognition of gain