☐ NEW ISI&E DIVISION RULES AND RULE AMENDMENTS IN PROCESS

Listed below, under Parts A and B, are proposed new administrative rules and amendments to existing rules that are currently in the rule adoption process. The rules are shown at their state in the process as of October 1, 1991. For the period from July 2, 1991 to October 1, 1991, Part C lists new rules and amendments which became effective, Part D lists rules withdrawn from promulgation, and Part E lists emergency rules which expired. ("A" means amendment, "NR" means new rule, "R" means repealed, and "R&R" means repealed and recreated.)

A. Rules at or Reviewed by Legislative Council Rules Clearinghouse

11.05 Governmental units-A
11.33 Occasional sales-general-A
11.34 Sales of business or business assets-A
11.50 Auctions-A
11.69 Financial institutions-A
11.83 Motor vehicles-A
11.84 Aircraft-A
11.85 Boats, vessels and barges-A
11.88 Mobile homes-A

B. Rules at Legislative Standing Committee

11.01 Sales and use tax return forms-A
11.47 Commercial photographers and photographic services-A

C. Rules Adopted in Period From July 2, 1991 to October 1, 1991 (including effective date)

4.05 Taxicabs-NR (10/1/91)
4.54 Security requirements-NR (10/1/91)
4.55 Ownership and name changes-NR (10/1/91)
9.68 Ownership and name changes-NR (10/1/91)
11.03 Elementary and secondary schools and related organizations-A (10/1/91)

D. Rules Withdrawn From Promulgation

3.11 Member of a reserve component of the armed forces serving in the Desert Shield or Desert Storm theater of operations-NR (withdrawn 9/18/91)

E. Emergency Rules Expired

3.11 Member of a reserve component of the armed forces serving in the Desert Shield or Desert Storm theater of operations-NR (expired 9/26/91)

☐ REPORT ON LITIGATION

This portion of the Wisconsin Tax Bulletin 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 has 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 the Commission's decision).

The following decisions are included:

INDIVIDUAL INCOME TAXES

Indians – other. *John A. Anderson vs. Wisconsin Department of Revenue* (Court of Appeals, District III, July 2, 1991). This is an appeal from a judgment of the Circuit Court for Sawyer County, which affirmed the Wisconsin Tax Appeals Commission determination that the taxpayer's income is subject to state income tax. The issues in this case are:

A. Whether the taxpayer, although he resides off-reservation in Wisconsin, is immune from state income tax for his on-reservation employment, based on *McClanahan v. State Tax Comm'n*, 411 U.S. 164 (1973).

B. Alternatively, whether state income tax on Indian income from reservation employment is an unreasonable interference with tribal sovereignty and has been preempted by federal law.

The taxpayer is an enrolled member of the Lac Courte Oreilles Band of the Lake Superior Chippewa Indians. The tribe employed him to work on the reservation in various educational activities. He is a resident of Wisconsin, living in Hayward, and is not domiciled on the reservation.

The taxpayer did not file Wisconsin income tax returns for the calendar years 1980 through 1983. He subsequently filed returns showing his income from off-reservation activities but exempting his on-reservation educational activities.

The Court of Appeals concluded as follows:

A. *McClanahan* is irrelevant to the issue in this case. In *McClanahan*, the individual lived and worked on the reservation. The Court specifically limited its holding, stating, "this case involves the narrow question whether the State may tax a reservation Indian for income earned exclusively on the reservation." The Court used the term "reservation Indian" to refer to an Indian living on the reservation. Because the taxpayer lives off-reservation, *McClanahan* does not preclude Wisconsin from taxing his on-reservation income.

B. Wisconsin's authority to tax income derived from on-reservation employment of a tribal member who resides off-reservation is neither an unreasonable interference with tribal sovereignty nor preempted by federal law.

The taxpayer has appealed this decision to the Wisconsin Supreme Court.

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Minimum tax — 1986. *Wisconsin Department of Revenue vs. Edward J. and Eleaner L. Blakely, and Richard N. and Marlene O. Mastenbrook* (Court of Appeals, District IV, August 1, 1991). The department appeals from an order of the Circuit Court for Dane County, which affirmed an order of the Wisconsin Tax Appeals Commission. The issue in the case is whether the taxpayers owe Wisconsin minimum tax for 1986, under sec. 71.60(1), Wis. Stats. (1985-86). See *Wisconsin Tax Bulletin* 70, page 10, for a summary of the Circuit Court decision.

The Circuit Court held that the Commission correctly interpreted Wisconsin law to permit an alternative calculation of federal tax liability without requiring an amended federal tax return. It based its conclusion on the Commission's interpreting sec. 71.60(1), Wis. Stats. (1985-86), to apply Internal Revenue Code sec. 55, as it was amended to December 31, 1986 ("old sec. 55"). The Commission held that the taxpayers did not owe Wisconsin minimum tax for 1986 despite their federal returns showing a federal alternative minimum tax, as long as the total federal income tax liability remains the same as that indicated on the federal income tax forms.

The Court of Appeals concluded that the Circuit Court's opinion correctly states the law.

The department has not appealed this decision.

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Compensation for services. *A. Yale Gerol vs. Wisconsin Department of Revenue* (Court of Appeals, District II, May 22, 1991). This is an appeal from an order of the Circuit Court for Racine County, which upheld a Wisconsin Tax Appeals Commission ruling that the department's reallocation of income was proper. The issue on this appeal is whether the department properly reallocated certain income reported by the taxpayer's service corporation to the taxpayer personally.

The taxpayer is a neurosurgeon and neurologist. In 1975, he organized a professional service corporation. The taxpayer entered into an employment contract with the clinic, which provided that he accepted employment with the clinic as its president and principal executive officer. The agreement also obligated him to practice medicine only for the clinic unless otherwise authorized by the clinic's board of directors, and it gave the clinic full supervisory authority over the conditions of his employment. Pursuant to the agreement, all fees engendered by the taxpayer's medical services belonged to the clinic.

In 1984, the taxpayer suffered an arm injury, and as a result, he decided to discontinue his neurosurgery and neurology practice. On August 27, 1984, St. Catherine's Hospital and Medical Center (St. Catherine's) offered to hire him, as an independent contractor, to serve as the hospital's "half-time" medical director. The taxpayer signed his acceptance of this offer on August 31, 1984. On its face, the taxpayer's signature does not indicate that he signed this agreement in any representative capacity. A contemporaneous addendum to this agreement also carried his signature without any such qualification. On April 3, 1985, the parties signed a modification to this agreement, changing the medical director's position from part-time to full-time. Again, the taxpayer did not sign in any representative capacity. Although the agreement did not so provide, St. Catherine's made all payments called for under the agreement to the clinic. The clinic, in turn, reported this income on its 1984-85 corporate income tax returns.

In October 1987, the department issued an assessment to the taxpayer, part of which represented the department's reallocation of the St. Catherine's payments from the clinic to the taxpayer. He appealed to the Commission, which determined that the department correctly reallocated the disputed income to the taxpayer, based upon the following facts: (1) St. Catherine's solicited and hired the taxpayer, not his service corporation clinic; (2) St. Catherine's contracted with the taxpayer, not his service corporation clinic; (3) the taxpayer contracted with St. Catherine's personally, not on behalf of his service corporation clinic; and (4) the clinic had no meaningful control or supervision over the taxpayer's duties as St. Catherine's medical director. Upon the taxpayer's petition for judicial review, the Circuit Court upheld the Commission's decision and order.

The Court of Appeals concluded that the facts, as found by the Commission, well support the Commission's legal conclusion that the taxpayer -- not his personal service corporation -- earned the income paid by St. Catherine's, and that the Commission correctly concluded that the taxpayer failed in his burden to demonstrate error in the department's assessment.

The taxpayer has not appealed this decision.

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Refunds, claims for — statute of limitations. *Gary Lotzer vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, July 25, 1991). The issue in this case is whether the refund claimed by the taxpayer on his 1983 income tax return should be allowed as an offset to the department's assessment which covered the period of 1983-1985. The 1983 return was filed after the statutory deadline.

On April 18, 1989, the taxpayer and his wife mailed their 1983 and 1984 Wisconsin income tax returns to the Wisconsin Department of Revenue. The taxpayer claimed a refund of $1,427 on the 1983 return, to be applied to the taxpayer's 1984 estimated tax payments. The taxpayer's 1984 return showed a net tax due of $901, which the taxpayer offset with the $1,427 claimed refund from 1983, thus claiming a refund of $526 for 1984. On July 15, 1989, the taxpayer and his wife mailed their 1985 Wisconsin income tax return to the Wisconsin Department of Revenue. The 1985 return showed a net tax due of $377. The 1985 return was not accompanied by a payment of any tax or interest.

The department made an adjustment to the taxpayer's 1984 Wisconsin income tax return by disallowing the $1,427 claimed refund on the 1983 Wisconsin income tax return, because it determined the 1983 claimed refund was filed beyond the four year statute of limitations. Thus, the department issued an assessment for $901 tax, plus interest and late filing fee.

The department adjusted the taxpayer's 1985 Wisconsin income tax return by calculating the gross tax to be $1,486 rather than the $1,395 calculated by the taxpayer. Thus, the net tax due for 1985 was increased from the $377 reported by the taxpayer to the $468 assessed by the department.

The Commission concluded that the taxpayer's 1983 refund claim should be allowed by the department since it relates to the tax period upon which the department's timely assessment was based. This result, allowing the taxpayer's refund claim filed after the statutory deadline had expired, is necessitated by the holding in *American Motors Corp. vs. Department of Revenue*, 64 Wis. 2d 337, 351-3, 219 N.W. 2d 300 (1974).

The department has not appealed but has filed a notice of nonacquiescence in regard to this decision.

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Refunds, claims for — statute of limitations. *Roger R. Zerbel and Laverne A. Zerbel vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, July 16, 1991, modified July 25, 1991). The issues in this case are:

A. Whether the taxpayer was entitled to a refund for 1983 or disqualified because of having filed the return for that year more than four years after its due date.

B. With the taxpayer having conceded that certain unreported pension income in the years 1984-87 was taxable and that the department's assessment of taxes against the taxpayer attributable to that income was correct, whether the department otherwise properly computed the taxpayer's tax liability for those years, or whether it omitted certain credits that would serve as offsets to that liability.

This case involves assessments for the years 1983-87. There were two assessments, the first covering 1983-85, and the second covering 1986-87.

The 1983 portion of the first assessment showed $0 tax liability, notwithstanding the fact that the auditor's supporting workpapers showed the taxpayer being entitled to a refund of $322. However, in the assessment, the refund was disallowed because the taxpayer had not filed any return claiming the refund within four years of the due date of the return. The 1984 and 1985 portions of the first assessment showed taxes, interest, and late fees assessed against unreported pension income, income that the taxpayer has conceded was taxable. The 1986-87 assessment was also attributable to unreported pension income.

At a hearing, the taxpayer complained that the department had failed to allow him credits against the tax, and as a result, the taxpayers were granted leave to file new returns for all the years involved, for the purpose of determining the validity of these claimed offsets. These returns were filed, but the department reviewed them and found that the credits claimed in excess of those allowed by the auditor were unsubstantiated. Subsequently, the taxpayer was directed to file with the Commission a statement particularizing the offsets to which he felt he was entitled. In a letter, the taxpayer protested only the department's denial of the dependent credit he claimed for a nephew but conceded that he had no way of proving the nephew's dependency.

The Commission concluded as follows:

A. Because the taxpayer did not file a 1983 refund claim within four years, the refund to which he is otherwise clearly entitled for 1983 is extinguished by lapse of time, and this is not a case of equitable recoupment because there is no 1983 tax liability to be absorbed by unused 1983 tax credits. The Commission subsequently reversed this conclusion and held that the taxpayer is entitled to receive credit for his unused 1983 refund claim of $322, against the amounts assessed for the other years covered by the 1983-85 assessment.

B. There is no evidence to support any credits beyond what the auditor allowed in the assessments.

Neither the department nor the taxpayer have appealed this decision.

CAUTION: This is a small claims decision of the Wisconsin Tax Appeals Commission and may not be used as a precedent. This decision is provided for informational purposes only.

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CORPORATION FRANCHISE OR INCOME TAXES

Unitary business. *Chilstrom Erecting Corp. vs. Wisconsin Department of Revenue* (Circuit Court for Milwaukee County, June 11, 1991). This is a judicial review of a decision by the Wisconsin Tax Appeals Commission (Commission). The issue in this case is whether the taxpayer's 1981-1985 out-of-state joint ventures constituted an integral part of a unitary business pursuant to sec. 71.07(2), Wis. Stats. (1985-86), and whether the resulting income was therefore subject to apportionment under the statutory formula. See *Wisconsin Tax Bulletin* 70, page 12, for a summary of the prior decision.

The taxpayer is a Wisconsin corporation whose principal place of business is in Milwaukee, and which is engaged in the construction industry by placing reinforcing steel (rebar) in concrete. The taxpayer's three part-time directors operate the business, whose staff also includes a full-time manager, two supervisors, and a part-time bid preparer. An accountant hired by the taxpayer reviews reports from both in-state and out-of-state projects and advises management of possible cost overruns. In Wisconsin the taxpayer usually acts as a subcontractor in projects involving rebar work. Its out-of-state joint ventures involve the placement of rebar in much larger construction projects. These joint ventures have project managers that are hired by the taxpayer and its joint venture partner, and the project managers hire all the needed laborers and equipment and take care of day-to-day management of the joint venture.

During 1981-1985 the taxpayer engaged in approximately seven out-of-state joint ventures. While these joint venture agreements were virtually identical, each was financially independent. The taxpayer and its joint venture partner contributed an equal amount of working capital to the ventures. The funds were kept separate by the joint venture and it obtained its own insurance. Title or registration of any equipment/vehicles was placed in the name of the joint venture, and each joint venture was responsible for its own day-to-day accounting functions. Thus, any pro rata share of any income/loss associated with these joint ventures was only reported by the taxpayer in the state where the project was located.

For the income tax years 1981-1985, the taxpayer filed its Wisconsin income tax returns on the basis of separate accounting, whereby only the income earned and losses suffered on the Wisconsin construction projects were included. The taxpayer did not apportion any of the income/losses from the joint ventures on its Wisconsin income tax returns.

The Circuit Court concluded that a rational basis did exist for the Commission's finding that the taxpayer's joint ventures constituted an integral part of a unitary business pursuant to sec. 71.07(2), Wis. Stats. (1985-86). Further, the Court concluded that the taxpayer failed to meet its burden of proof to overcome the presumption of correctness inherent in the department's assessment, and that by applying the apportionment formula to the taxpayer's joint venture income, Wisconsin is not in violation of either the Commerce Clause or the Due Process Clause of the U.S. Constitution.

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

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SALES/USE TAXES

Use — does not include. *Morton Buildings, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, July 26, 1991). The issue in this case is whether the taxpayer's bulk purchases of raw materials used in their manufacture of building components were subject to Wisconsin use tax whenever such building components were used by the taxpayer in Wisconsin real property construction activities. The taxpayer's purchases and manufacturing took place outside Wisconsin.

The taxpayer is an Illinois corporation, having its principal offices in Morton, Illinois. The taxpayer is engaged in the business of manufacturing building components for prefabricated buildings for use by farm and industry, and assembling the components at customer locations in many states throughout the United States, including Wisconsin. All of the building components involved were used by the taxpayer to assemble buildings that became permanent improvements to real property in Wisconsin.

The taxpayer purchases all of the raw materials used to manufacture the building components in bulk outside of Wisconsin, and stores them in its own warehouses outside of Wisconsin. The taxpayer does not purchase raw materials for application to any particular contract.

At its several factories outside Wisconsin, the taxpayer's employes manufacture the building components and some of the hardware used in assembling the buildings from raw materials previously purchased in bulk. The taxpayer does not maintain or operate any manufacturing plants in Wisconsin. A small amount of raw materials, building components, and certain construction equipment used to assemble the buildings may be stored at four Wisconsin sales offices.

When an order for a building is received, the necessary raw materials and hardware are withdrawn from inventory and are consumed and transformed by the taxpayer in the manufacture of finished building components in accordance with the customer's specifications. The manufacture of the building components takes place entirely outside of Wisconsin prior to the transport of the finished building components into Wisconsin for installation at customer sites.

The taxpayer's employes assemble the building components into the finished building at the customer's site. On occasion, certain concrete work, plumbing, and other utility work may be subcontracted out by the taxpayer. On other occasions, the building owners may independently perform or contract for their own concrete, plumbing, and other utility work following the taxpayer's completion of the building.

The Commission concluded that the taxpayer's purchases outside of Wisconsin of raw materials transformed by the taxpayer's out-of-state manufacturing operations into new items of tangible personal property were not subject to the use tax imposed under sec. 77.53(1), Wis. Stats., by virtue of the taxpayer's use of such manufactured tangible personal property as building components in Wisconsin real property construction activities.

The department has appealed this decision to the Circuit Court.

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OTHER

Open records law. *Mayfair Chrysler-Plymouth, Inc., vs. Nick Baldarotta, Legal Custodian of Records of the Wisconsin Department of Revenue, and Wisconsin Department of Revenue* (Wisconsin Supreme Court, May 23, 1991). This is a review of a decision of the Court of Appeals, affirming a judgment of the Circuit Court for Dane County. The Circuit Court judgment compelled the department to permit the taxpayer to inspect certain records in the department's custody relating to the department's audit of the taxpayer's tax returns.

This case presents two issues, as follows:

A. The first issue is whether the department's denial of access to portions of its records, on the ground that the information would reveal the identity of a confidential informant who provided information to the department under a pledge of confidentiality, satisfies the standards of legal specificity required by Wisconsin's Open Records Law, secs. 19.31-19.39, Wis. Stats., and the Wisconsin Supreme Court's prior decisions.

B. The second issue, which arises only if the department's denial was legally specific, is whether the existence of the department's pledge of confidentiality to the informant was a legally sufficient reason for denying access to records that overcomes the public policy presumption in favor of access to public records.

On January 13, 1988, the taxpayer submitted a written request to the department pursuant to sec. 19.35, Wis. Stats., to inspect and copy certain records in the department's possession. These records, which had been provided by a former employe of the taxpayer, consisted of checks and business records which related to alleged accounting procedures and practices of the taxpayer. The department denied the request on the ground that the information was not a "record" as defined in sec. 19.32(2), Wis. Stats. In response, the taxpayer initiated an action for mandamus relief, seeking release of the records pursuant to sec. 19.37(1)(a), Wis. Stats.

The Circuit Court held a telephone conference between the parties on June 15, 1988, in which the department agreed to provide the taxpayer redacted copies of documents it held relating to the taxpayer's business practices. These copies were edited to delete any references which would suggest the identity of the ex-employe informant who provided the information to the department. This sanitization erased all numeric figures from the documents creating, in effect, blank forms. At this time, the department also provided the Circuit Court with unredacted copies of the documents for *in camera* review.

The taxpayer then sent a supplemental request to the department seeking all records, including check stubs, cancelled checks, timecards, and other business records which were received from any source other than the taxpayer. The department denied this request, stating that it could provide no additional information because it had given a "pledge of confidentiality ... to the informant, [and] the department must continue to deny access to portions of records which may identify the informant."

The taxpayer then moved for summary judgment, seeking release of the records on the ground that the department's reasons for denying the request were not legally sufficient. The Circuit Court granted the request. The Court of Appeals affirmed, concluding that "the reasons asserted by the department were insufficient as a matter of law to support the denial of access to the records. ..."

The Wisconsin Supreme Court concluded that the department's denial of the taxpayer's record request satisfied the requirements of Wisconsin's Open Records Law because it was legally specific and legally sufficient. By informing the taxpayer that their request was being denied because a pledge of confidentiality had been given to a confidential informant who had provided the records, the department adequately communicated that the denial was based on the obvious and well-known law enforcement interests served by confidential informants. The denial was legally sufficient because the harm to the public interest in effective law enforcement from disclosing portions of records that could reveal the identity of a confidential informant outweighs the public interest in inspection of those records. The Supreme Court also concluded it is in the public interest to permit the department to provide pledges of confidentiality to citizens who may not otherwise step forward to assist law enforcement efforts.

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. 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. Farm Loss Carryover

Statutes: Section 71.05(6)(a)10 and (b)10, Wis. Stats. (1987-88)

Note: This tax release applies only with respect to taxable year 1988 and thereafter.

Background: Effective for taxable year 1986 and thereafter, sec. 71.05(6)(a)10, Wis. Stats. (1987-88), limits the amount of farm loss that may be deducted each year. The limitations are based on the amount of the taxpayer's nonfarm Wisconsin adjusted gross income.