Report on Litigation

Summarized below are recent significant Wisconsin Tax Appeals Commission (WTAC) and Wisconsin Court decisions. The last paragraph of each decision indicates whether the case has been appealed to a higher Court.

The following decisions are included:

INDIVIDUAL INCOME TAXES

Farm losses — limitation — 1986 and thereafter. *Dennis L. and Janet Oliver vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, June 29, 1992). The issue in this case is whether the department correctly determined the amount of farm loss subject to limitation.

The department made adjustments to the taxpayer's 1986 and 1988 income tax returns, applying a farm loss limitation to each, which resulted in a partial disallowance of losses claimed and an additional assessment of income taxes. The department limited the taxpayers' 1986 farm loss to $12,500 and the 1988 farm loss to $15,000.

The taxpayers argue that their net profit from horses and their ordinary gain from the sale of horses should be used to offset their loss from livestock and grain. This, they contend, would produce a net loss within the $12,500 loss limitation.

The taxpayer's argument relies on sec. 71.05(1)(a)26, Wis. Stats. (1985-86), which provides for an addition to federal adjusted gross income for "combined net losses exclusive of net gains ... incurred in the operation of a farming business." They assert that the phrase "combined net losses" requires a netting of all ordinary income and loss items relating to the farming operation.

The department replies that the governing statute is sec. 71.05(1)(a)26, Wis. Stats., as amended by 1987 Wisconsin Act 27, which provides that the add back to federal adjusted gross income is for "combined net losses, exclusive of net gains from the sale or exchange of capital or business assets and exclusive of net profits ... incurred in the operation of a farming business ..."

The Commission concluded that sec. 71.05(1)(a) 26, Wis. Stats., as amended by 1987 Wisconsin Act 27 first applies to taxable year 1986, and the taxpayers are not allowed an offset as sought against the department's 1986 farm loss disallowance. The taxpayers failed to show that the department's 1988 assessment was incorrect in any manner.

The taxpayers have not appealed this decision. □

Indians — marital property law. *Lee A. and Beverly J. Anderson vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, August 28, 1992). The issues in this case are:

A. Whether the state can tax, as marital income imputed to a non-Indian spouse, one-half of the income earned on-reservation by an Indian resident of the reservation.

B. Whether the Wisconsin Marital Property Act, Chapter 766, Wis. Stats., applies where one spouse is an Indian and the couple lives on that spouse's reservation within Wisconsin.

This case concerns income earned by the Andersons during the years of 1986 through 1989. The following facts pertain to all of the years at issue.

Beverly J. Anderson is an enrolled member of the Oneida Tribe of Indians of Wisconsin, a federally recognized Indian tribe, and is married to Lee A. Anderson, a non-Indian.

The Andersons were domiciled and resided on the Oneida Indian Reservation, and Beverly J. Anderson's

reported income consisted entirely of wages earned by her on the Oneida Indian Reservation, rental income from property owned by her on said reservation, and her interest and pension income. Lee A. Anderson's wage income was earned by him solely outside the Oneida Indian Reservation and exceeded Beverly's income from all sources.

The Andersons reported as due and paid the tax due on the income earned by Lee, the non-Indian spouse, but did not pay tax on any portion of the income earned by Beverly.

The Oneida tribe of Indians have not acted to remove the tribe from the operation of the Wisconsin marital property law. The Andersons did not enter into a marital property agreement providing that Beverly's wage and other income was her individual property and that Lee did not have an undivided one-half interest in such income; nor did they enter into any similar agreement respecting Lee's income and Beverly's interest therein. No court order existed that provided that Lee did not have a marital property interest in Beverly's income, nor did any similar court order exist respecting Beverly's marital property interest in Lee's income.

The Commission concluded:

A. Although the Wisconsin Marital Property Act, Chapter 766, Wis. Stats., may give Lee a one-half interest in Beverly's income earned on the reservation, it cannot change the character of such income to become instead income earned by a non-Indian.

B. Because the income earned by Beverly retains its character as reservation income earned by a reservation Indian, it is exempt from state taxation under federal law notwithstanding the Wisconsin Marital Property Act, Chapter 766, Wis. Stats.

The department has not appealed this decision. □

Indians — other. *John A. Anderson vs. Wisconsin Department of Revenue* (Wisconsin Supreme Court, June 23, 1992) This is a petition for review of a decision of the Court of Appeals, District III, which held that the taxpayer's income is subject to state income tax. See *Wisconsin Tax Bulletin* 74, page 12, for a summary of that decision.

The issue in this case is whether the state of Wisconsin has the authority to tax the income of a member of the Lac Courte Oreilles Band of the Lake Superior Chippewa Indians (the tribe), earned from tribal educational activities conducted on the Lac Courte Oreilles reservation, when the member lives off the reservation.

The taxpayer is an enrolled member of the tribe and did not file Wisconsin income tax returns for the years 1980 through 1983. During those years, the taxpayer lived in Hayward, Wisconsin, and was employed in various educational capacities by the tribe on the reservation.

The department issued a notice of assessment against the taxpayer based upon the department's estimate of his income for the years 1980 through 1983. The taxpayer subsequently filed Wisconsin individual income tax returns for these years. On those returns, he identified his investment income and outside speaking income as taxable by the state, but subtracted his wages earned on the reservation as nontaxable.

The taxpayer argues that Wisconsin's ability to tax his on-reservation income is preempted by federal law, that the tax places an impermissible burden on the tribe and infringes on the tribe's sovereignty, and that the tax is contrary to the Supreme Court's decision in *McClanahan vs. Arizona State Tax Comm'n*, 411 U.S. 164 (1973).

The department responds that because the taxpayer is a resident of the state and not the reservation, his income is subject to taxation; that the state's ability to tax the taxpayer's income is not preempted by federal law; that the tax does not impermissibly burden the tribe nor infringe upon the tribe's sovereignty; and that the tax does not violate *McClanahan*.

The Supreme Court concluded that the tax on the taxpayer's income does not place an impermissible burden on the tribe and does not interfere with the tribe's sovereignty. The tax does not violate *McClanahan*, since the term "reservation Indian" refers to an Indian living on the reservation.

The taxpayer has appealed this decision to the United States Supreme Court. □

Tax Appeals Commission — class action claims — prospective rulings. *J. Gerard and Delores M. Hogan, et al., vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, October 28, 1992.) There are two issues in this ruling and order on motions:

A. Can Wisconsin Tax Appeals Commission rulings on refund claims ever be "prospective"?

B. Can the Commission hear class action tax claims?

The taxpayers filed a refund claim for 1988 on April 17, 1989, and an amended refund claim for 1982-1988 on April 16, 1990. They argued that

Wisconsin, like Michigan in *Davis v. Michigan Dept. of Treasury*, had wrongfully and unconstitutionally collected income taxes on federal retirement benefits while simultaneously exempting the retirement benefits of certain retired state and government local employes.

The taxpayers' amended refund claim added as additional claimants all members of the class that they had been certified to represent in separate court litigation. The amended refund claim was signed by the lawyer authorized to represent the class. The state denied both the taxpayers' and the class claim on the grounds that the law made no provision for class tax refund claims. See *Wisconsin Tax Bulletin* 75, January 1992, for a summary of the Wisconsin Supreme Court decision (June 26, 1991) in *Hogan et al. vs. Wisconsin Department of Revenue*. The United States Supreme Court denied the taxpayers' petition for review of the Wisconsin Supreme Court decision, on January 13, 1992.

The Commission upheld the taxpayers' motion to strike the department's argument that refund claims can only be applied prospectively, and it overruled the department's motion for dismissal of the class action. The Commission concluded:

A. Wisconsin Court or Commission decisions upholding refund claims or assessments are always retroactive and never prospective.

B. Since agents can act for principals in meeting statutory requirements imposed on their principals, the class refund claim was properly filed at the Department of Revenue, and the department and Commission have jurisdiction to rule on the class claim. □

SALES AND USE TAXES

Retailer — defined.

Joseph Sanfelippo vs. Wisconsin Department of Revenue, (Court of Appeals, District IV, July 9, 1992). This is an appeal from an order of the Circuit Court of Dane County, which concluded that the transactions between the taxpayer and his drivers are not taxable. For a summary of that decision, see *Wisconsin Tax Bulletin* 71, page 12.

The issue is whether the taxpayer's receipts from taxicabs leased to drivers are subject to sales tax. During the years at issue, 1981-84, the taxpayer orally leased his cabs to drivers for $100 to $125 per week. He exercised no control over the drivers and took no share of their fares. They paid for the gas and some maintenance.

The taxpayer argues that his leases to cab drivers are not taxable because each transfer is for the purpose of "resale" under sec. 77.52(1), Wis. Stats., since the drivers use the cabs to serve the passenger public. He relies on *Dept. of Revenue v. Milwaukee Refining Corp.*, 80 Wis.2d 44, 257 N.W.2d 855 (1977).

The taxpayer maintains that when he leases a cab to a driver, that is not the "final and ultimate employment" of the cab. The "final and ultimate employment" occurs, he asserts, when a driver transports a passenger in exchange for a fare. This is when the cab is withdrawn from the marketplace of goods and services.

Finally, the taxpayer asserts that the department had once taken the position that cab owners who had an employer-employee relationship with their drivers could not be subject to the sales tax. In 1974, the Wisconsin Department of Industry, Labor and Human Relations, for unemployment compensation purposes, ruled that the taxpayer was in such a relationship. The taxpayer argues that these two positions, taken together, render the statute ambiguous as applied to him.

The Court of Appeals reversed the Circuit Court's decision, concluding that the lease payments are sales at retail and are subject to sales tax. The taxpayer's drivers do not resell, release, or sublease the cabs. His drivers do not transfer ownership of, title to, or possession of the cabs to passengers.

The Court of Appeals also concluded that sec. 77.51(14)(j), Wis. Stats., was not ambiguous as it applied to the taxpayer. It applies to tangible personal property, including cabs, and the record fails to disclose that the department had once taken the position that the taxpayer's transactions were not subject to tax.

The taxpayer appealed this decision to the Wisconsin Supreme Court, which denied the petition for review. □