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

Appeals — appeal procedure. *Oliver G. and Jeanne K. Berge and Wilmer E. and Marijean Trodahl vs. Wisconsin Department of Revenue* (Circuit Court for Dane County, February 3, 1993). The taxpayers brought this action for judicial review of the decision and order of the Wisconsin Tax Appeals Commission (Commission) dated March 11, 1992. See *Wisconsin Tax Bulletin* 79 (October 1992), page 9, for a summary of that decision. The issue is whether the Circuit Court has subject matter jurisdiction to review the Commission's decision.

The decision of the Commission was mailed to the parties on March 11, 1992. The taxpayers filed a petition in Dane County Circuit Court for judicial review of the Commission's decision on April 7, 1992. The Commission was served with a copy of the petition on April 7, 1992. It is undisputed that the department was a party who appeared before the Commission and the department has not been served with a copy of the petition for judicial review.

The Circuit Court concluded that the taxpayers have failed to follow the prescribed procedure and the Circuit Court is therefore without subject matter jurisdiction to review the Commission's findings and order.

The Court granted the department's motion to dismiss and dismissed the taxpayers' action for judicial review.

The taxpayers have not appealed this decision. □

Credits — taxes paid to other states; Income attribution; Penalties — fraud. *Paul G. Beck and Judith I. Beck vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, February 23, 1993). The issues in this case are:

A. Whether the taxpayers were entitled to credits against Wisconsin income taxes for Illinois income taxes they paid in 1977-82.

B. Whether income earned by "Sue Sales" and "Paula Enterprises," sole proprietorships named after the taxpayers' daughters, Sue and Paula, in 1979-81 when the girls were ages 11-13 and 15-17, respectively, was the girls' income or the taxpayers' income.

C. Whether the taxpayers were entitled to have their assessment reduced by the amount of estimated taxes paid on behalf of the proprietorships at the time the proprietorships were operating and by the amount of doomage taxes paid by the daughters, if the income of the proprietorships was income to the taxpayers and not their daughters.

D. Whether the department was justified in imposing a 50% penalty against Mr. Beck for the years 1977-82 and for Mrs. Beck for 1977-80.

The taxpayers' daughters worked in the businesses 5 to 7 hours per week. The taxpayers paid them a modest salary for their work, the girls had no profit-sharing interests in the businesses, and substantial amounts of the businesses' receipts were withdrawn and deposited in bank accounts the taxpayers controlled.

The taxpayers delayed until 1989, the filing of the Wisconsin returns claiming the credits for Illinois income taxes paid. This was beyond the 4-year statute of limitations.

The taxpayers, on February 19, 1985, were convicted of failing to file returns and failing to pay taxes for 1981, 1982, and 1983. On March 1, 1985, the taxpayers were sentenced and ordered to file returns for 1977-84 by March 1, 1986. None of the 1977-82 returns were filed until 1989. The taxpayers did pay substantial estimated Wisconsin and Illinois income taxes in the years 1977-81.

The Commission concluded:

A. Because of the doctrine of equitable recoupment, the amended assessments will be modified to reduce the "Adjusted Net Income Tax" by the amount of the appropriate credit for Illinois income taxes paid.

B. Because the taxpayers paid their minor daughters a salary for their work in the businesses, and because the daughters had no share in the businesses' profits, the businesses' income was not earned by them. Because the monies the businesses earned were deposited into accounts controlled by the parents, and from which the parents made substantial withdrawals, the income was properly attributed to the taxpayers, the persons who actually earned the income.

C. Because the income from sales of the two proprietorships is attributed to the parents, it necessarily follows that the parents, not the children, ought to get credit for estimated Wisconsin income taxes paid in the names of the daughters and credit for the doomage payment.

D. The taxpayers are liable for the 50% penalty. The taxpayers, without explanation, delayed the filing of their returns for periods ranging from 6 to 11 years after they were due, four years after the judge in their criminal case ordered them to file, and three years after the department issued the doomage assessment in this case.

The taxpayers have appealed this decision to the Circuit Court. The department has not appealed the decision but has adopted a position of nonacquiescence in regard to that portion of the decision regarding credit to the taxpayers for the daughters' income taxes or assessments (Issue C). □

Federal retirement income — taxability. *J. Gerard and Delores M. Hogan, et al. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, oral decision, May 27, 1993).

The issue in this case is whether the taxpayers (a class including all federal pensioners who had paid Wisconsin income taxes on their federal pensions in any of the years 1984-88 and who had been members of a federal retirement program as of December 31, 1963) are entitled to refunds of Wisconsin income taxes they paid on their federal pensions in 1984-88. See page 18 of this Bulletin for a summary of an earlier Commission decision in this matter.

The taxpayers filed a summary judgment motion with the Commission. Both parties agree there is no genuine issue as to any material facts.

During the years 1984 through 1988, the State of Wisconsin imposed and collected an income tax on pensions received by individuals who had

worked for and subsequently retired from the federal government.

During the same years, the pensions received by individuals who had worked for and subsequently retired from selected state and local governments as of December 31, 1963, were exempt from the same Wisconsin income tax.

The taxpayers believe that they have been unlawfully discriminated against and are claiming a refund of income taxes they have paid.

The department denied their claim.

There is no dispute that the taxpayers paid the taxes in question in each of the years or as to the actual dollar amount of their respective claims.

Prior to 1939, prevailing law held that the states were precluded from taxing the compensation, both current and deferred, of those who worked for the federal government.

Simultaneous with Congress' enactment of the Public Salary Tax Act of 1939 — now codified as 4 United States Code (USC) 111 — the Wisconsin Legislature enacted Chapter 293, Laws of Wisconsin 1939, which paralleled the provisions of the federal law. The gist of both of these laws was to allow Wisconsin to tax income received by federal employes as long as there was no discrimination as to the source of that income.

Both of these federal and state laws were in effect during the entire period.

The exemption for federal retirees continued until the mid 1960's, when the Wisconsin Legislature repealed it. The exemption for selected state retirees continued in full force and effect.

On March 28, 1989, the United States Supreme Court held that the Michigan income tax provisions according preferential treatment to state and local employe retirement income was in violation of principles of intergovernmental tax immunity as codified in 4 USC 111, in the landmark case of *Davis v. Michigan Department of the Treasury*, 489 U.S. 203. Shortly after that decision, Wisconsin legislatively expanded the exemption to federal retirees.

The Commission concluded that the exemption favoring state and local pensioners over federal pensioners is facially discriminatory and does not meet the source test contained in 4 USC 111 and/or the intergovernmental immunity standard as enunciated by the United States Supreme Court in the *Davis* case. The taxpayers are entitled to refunds of Wisconsin income taxes paid on federal pensions.

The department has appealed this decision to the Circuit Court. □

Indians — other. *John A. Anderson vs. Wisconsin Department of Revenue* (Wisconsin Supreme Court, June 23, 1992). See *Wisconsin Tax Bulletin* 80 (January 1993), page 19, for a summary of the June 23, 1992, decision.

The taxpayer appealed the Wisconsin Supreme Court decision to the United States Supreme Court in September 1992. The United States Supreme Court denied the taxpayer's petition for review in May 1993. □

Refunds, claims for — office audit — within 2 years following. *Stephen and Theresa Maryarski vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, February 23, 1993). The issue in this case is whether the taxpayers' claim for refund was timely filed.

The taxpayers were assessed additional income taxes in 1986 and after their objections were denied by the department in 1989, filed an untimely petition for review with the Commission, which was dismissed for lack of jurisdiction because it was filed late. They then paid the assessments in 1990 and 1991 and filed a claim for refund with the department in 1992, which the department rejected.

The taxpayers advance two reasons why their refund claim should be allowed. First, they argue that their initial letter dated March 10, 1986, objecting to the assessments, "was not a timely filed petition for redetermination" and therefore they are not barred by sec. 71.75(5), Wis. Stats., from seeking a refund. Second, they argue that the ***payment*** date rather than the ***assessment*** date tolls the two year refund claim period, which would then bring their refund claim within the permissible filing time.

The Commission concluded, as to the first argument, that the taxpayers offer no evidence in support of it. The department's exhibits clearly show that the taxpayers were notified of the denial of their "petition for redetermination" and advised of their rights of appeal to the Commission, which they failed to exercise in timely fashion.

The Commission concluded that the taxpayers' second argument also fails. The language of sec. 71.75(5), Wis. Stats., is clear that the refund claim must be made "within two years after the ***assessment***" (emphasis added) or within two years of ***payment "if the assessment was not protested by the filing of a petition for redetermination*** (emphasis added)." Here the taxpayers clearly missed the two-year deadline after assessment and, because they "protested" the assessment by petitioning for redetermination ("objected," by their terminology), did not qualify for the two-year deadline following payment.

The department has not appealed the decision but has adopted a position of nonacquiescence in regard to that portion of the decision interpreting sec. 71.75(5), Wis. Stats., to permit refund claims made within two years of the date of ***payment*** of an assessment. The taxpayers have not appealed the decision.

Note: It is the department's position that the two-year filing period for a claim for refund under sec. 71.75(5), Wis. Stats., begins on the date the assessment is issued (the date on the notice), not the payment date, regardless of whether the assessment is protested or not. The effect of the department's nonacquiescence is that the Commission's interpretation is not binding in other cases. □

Tax Appeals Commission — class action claims.

J. Gerard and Delores M. Hogan, et al., vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, ruling and order, February 16, 1993). The department seeks reversal of the Commission's October and November 1992 ruling that the taxpayers, who are federal pensioners, can proceed as a class in their attempt to recover Wisconsin income taxes they paid on their federal pensions in 1984-88. See *Wisconsin Tax Bulletin* 80 (January 1993), page 19, for a summary of that ruling, and see page 16 of this Bulletin for a summary of related Commission decision in this matter.

In the October and November 1992 ruling, the Commission noted that the statutes gave it the authority to prescribe rules of practice and procedure, and that pursuant to that authority, it had prescribed a rule that incorporated the rules of civil procedure courts follow. It reasoned that because the rules of civil procedure explicitly allow class actions, class actions were made part of the Commission's "authorized procedural machinery"; and went on to hold that because the department had not objected either to the composition of the class or to the class attorney's qualifications, class and attorney would be certified.

As a result, the Commission held that the class would include all federal pensioners who had paid Wisconsin income taxes on their federal pensions in any of the years 1984-88 and who had been members of a federal retirement program as of December 31, 1963, that date being the parallel membership date certain Wisconsin state and local pensioners by statute had to meet to qualify to have their pensions exempted from tax.

The department asked for a rehearing. In support of its motion for reversal, it presented four arguments:

A. "Class action proceedings are inherently equitable proceedings"; the Commission has no equitable jurisdiction; therefore the Commission has no authority to hear class actions;

B. To have the case proceed as a class action would abrogate the department's "absolute statutory right" to examine each of 25,000 members of the class under oath;

C. Sovereign immunity (precluding claims against the state unless expressly allowed) precludes class tax refund claims in that the refund claim statute makes no mention of such claims;

D. Taxpayers don't need to utilize class actions, because an individual taxpayer victory is a stare decisis victory adequate in and of itself for all other taxpayers with like tax controversies.

The department also raised the alternative arguments:

E. Even if the case can proceed as a class action, the Commission's class certification was improper in this instance,

   1) Because the Commission "summarily certified" the class without considering whether the class composition was appropriate; and

   2) Because the Commission defined the federal class too broadly, failing to consider "a host of issues" including whether the federal class should have excluded various non-similarly-situated federal pensioners including those who had no 1963 Wisconsin tax filing obligations, who weren't city or county of Milwaukee residents in 1963, who had jobs that weren't comparable with the jobs of exempt pensioners, who weren't members of an annuity or retirement fund as

that term is defined in the Wisconsin statutes, whose pensions didn't derive from public employee contract rights, or who were merely "constructive members" of a federal retirement plan on December 31, 1963. In addition, the department suggests that the exemption was "truly intended to account for differences in retirement benefits."

F. The Commission failed to recognize that Wisconsin's exemption is a "partial exemption" that doesn't exempt all state pensioners, but only some, and the class the Commission certified would give some dissimilarly-situated federal pensioners an "unfair windfall" at the expense of state pensioners who don't qualify.

The Commission concluded:

A. Whether class actions are equitable or not is beside the point, for today equity and law are for the most part indistinguishable, and the law governing tax litigation procedure has absorbed the "equitable" class action procedure as part of the law's tax resolution process.

B. Because the individual federal pensioners here can give no probative testimony on either point, and because neither the amount nor character of their pension income, nor as yet the amount of any individual refunds owing, are at issue, there is no need in the liability phase for any personal appearance by any of the pensioners.

C. The sovereign immunity defense fails, because the statutes, taken as a whole, authorize the filing and prosecution of class tax claims.

D. Class actions provide a supplemental means of resolving cases, a means that the legislature endorsed not in lieu of stare, but in addition to it.

E. Where, as here, it is alleged that a state taxing statute discriminates against federal pensioners in favor of some select state pensioners, for standing purposes no "actual" comparison of the federal pensioners and the selected state pensioners need be made, because each federal pensioner is deemed by federal law to have the requisite common attributes with, and be similarly-situated to, the favored state pensioners. Here commonality is presumed, and the federal pensioners can proceed as a class to stand or fall, all for one and one for all, as a group.

Consequently, the Commission need not reach the department's host of issues because each wrongly assumes that each federal pensioner must demonstrate an "actual" similarity, when in fact that similarity has already been constructed by law.

The three other prerequisites for a class action are established: there is a commonality of interest shared by all federal pensioners seeking certification, the main party, Mr. Hogan, does fairly represent the group, and it would be impracticable to bring all 25,000 individuals that make up the class into individual Commission hearings or one mass hearing.

F. Although some federal pensioners may win an "unfair windfall" in the sense that they would be getting something some state pensioners, suffering perhaps greater comparative discrimination, might not be entitled to receive, that is no legal reason for excluding any federal pensioners from the class.

The department has appealed this decision to the Circuit Court. □

CORPORATION FRANCHISE AND INCOME TAXES

Appeals — Tax Appeals Commission; Charitable contributions — 1986 and prior — carryover. *Beemster Liquidation, Inc., vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, October 21, 1992). This is a decision on the taxpayer's petition for rehearing regarding the Commission's July 28, 1992, decision. The issues in this case are:

A. Whether the taxpayer's petition for rehearing was timely filed.

B. Whether the taxpayer may carry over a charitable contribution deduction from 1983 to 1987.

The taxpayer made charitable contributions in 1983 and carried forward a portion of the deduction to its 1987 tax return. The department disallowed this deduction, taking the position that, although allowable for federal purposes for 1987, the 1983 charitable deduction had expired for Wisconsin purposes for 1987.

In an oral decision on July 28, 1992, the Commission affirmed the department's assessment against the taxpayer.

Upon reviewing its earlier decision and the arguments of counsel, the Commission reversed its decision, concluding that:

A. The taxpayer's petition for rehearing was timely filed. The Commission held that the taxpayer's reliance on the rule for filing a petition for review was reasonable.

B. Section 71.26(2), Wis. Stats. (1987-88), used corporate "gross income as computed under the Internal Revenue Code," in computing Wisconsin "net income." Section 170, IRC, amended to December 31, 1986, allowed the contribution carryover at issue. The Commission concluded that the carryover must be allowed for Wisconsin purposes even though any Wisconsin carryover under prior law may have expired.

The department has not 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.

Note: The department's position regarding the carryover of charitable contributions has not changed as a result of this decision. □

Apportionment — factors; Dividends — deductible dividends. *Honeywell Bull, Inc. f/k/a Honeywell Information Systems, Inc., and Honeywell, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 13, 1993). The issues in this case are:

A. Whether the dividend received by the taxpayer Honeywell, Inc. (HI) from its wholly-owned subsidiary Honeywell Bull, Inc., formerly known as Honeywell Information Systems, Inc. (HISI), was a "cash dividend" so as to entitle HI to the 75% dividend received deduction under sec. 71.04(4)(b), Wis. Stats. (1983).

B. Whether the dividend received by HI from HISI should be excluded from HI's Wisconsin apportionable income because the statutory scheme embodied in secs. 71.01(1m) and 71.04(4), Wis. Stats., unlawfully discriminates in favor of local business at the expense of business conducted in interstate commerce in violation of the Interstate Commerce Clause and the Equal Protection Clause of the Fourteenth Amendment of the United States Constitution.

HISI is engaged in the manufacture and sale of computers and has its principal offices in Minneapolis, Minnesota. HI is engaged in the manufacture and sale of a variety of products and has its principal offices in Minneapolis, Minnesota. During the years 1983 through 1986, inclusive, HISI was a wholly-owned subsidiary of HI.

Pursuant to a 1970 letter agreement among General Electric Company, HISI, and HI, in the aggregate principal amount of $638,314,259.93, HI issued to HISI a series of promissory notes (the "Notes") as payment for inventory items purchased by HI from HISI.

On November 29, 1984, the Board of Directors of HISI adopted a consent resolution declaring a dividend payable to HISI's sole shareholder, HI, effective as of January 1, 1984, in the amount of $638,314,259.93. Also on November 29, 1984, W.L. Jorgenson of HI wrote a memorandum to V. M. Bjornberg of HISI, wherein he directed that prior to closing HISI's books for November 1984, all retained earnings as of December 31, 1983, from various HISI subsidiaries be transferred to HISI. He directed further that upon completion of such transfer, the dividend declared by the November 1984 HISI consent resolution was to be recorded on the books of HISI with the explanation that a dividend was paid by the transfer of the outstanding balance of the interest-bearing note account from HI. Similar contra entries were to be made on HI's books. In addition, he prescribed book entries for the November and December 1984 consolidated accounts for HISI and HI. On November 30, 1984, HISI and HI made entries on their respective books and records reflecting the dividend and the elimination of the note payable.

The Commission concluded that:

A. The dividend received by HI from its wholly-owned subsidiary, HISI, was a "cash dividend" within the meaning of sec. 71.04(4)(b), Wis. Stats. (1983).

B. The statutory scheme embodied in secs. 71.01(1m) and 71.04(4), Wis. Stats., unlawfully discriminates in favor of local business at the expense of business conducted in interstate commerce, in violation of the Interstate Commerce Clause of the United States Constitution (Art. I, Sec. 8, cl. 3).

The department has appealed this decision to the Circuit Court. □