

— Apportionment — factors; Dividends — deductible dividends; Foreign source income. *Wisconsin Department of Revenue vs. NCR Corporation* (Circuit Court for Dane County, April 30, 1993). Both the department and NCR Corporation (NCR) seek judicial review of a February 10, 1992, decision of the Wisconsin Tax Appeals Commission (Commission). In its decision, the Commission determined that:

(1) Inclusion in NCR's 1975 through 1980 Wisconsin apportionable income of foreign-source income consisting of dividends, interest, and royalties received from NCR's foreign subsidiaries of its unitary business does not violate the Foreign Commerce Clause of the United States Constitution;

(2) The application of Wisconsin's statutory apportionment formula to NCR's unitary business violated the Due Process and Foreign Commerce Clauses, and the Wisconsin apportionment statute by not taking into account foreign subsidiary payroll, property, and sales factors;

(3) The "California Twist Cap" method of apportionment is a constitutionally and statutorily permissible alternative for allowing the property, payroll, and sales of NCR's foreign subsidiaries to be accounted for in NCR's Wisconsin apportionment factors;

(4) The inclusion in NCR's Wisconsin apportionable income of dividends received by NCR from corporations whose business is not primarily attributable to Wisconsin violated the Equal Protection Clause but not the Interstate Commerce Clause;

(5) "Inside source dividends" were not "dividends" under sec. 71.04(4),

Wis. Stats., as in effect during the years 1975 through 1979 and, therefore, no deduction would have been allowed for "inside source" dividends received from a unitary subsidiary apportioning 50% or more of its income to Wisconsin.

See *Wisconsin Tax Bulletin 76* (April 1992), page 5, for a summary of the Wisconsin Tax Appeals Commission's decision.

The department challenges the Commission's conclusion that when the department included in NCR's apportionable income the income from its foreign subsidiaries but then failed to take account of the foreign subsidiaries' payroll, property, and sales in the formula factors, it violated the Due Process and Foreign Commerce Clauses of the U.S. Constitution. It further argues that the Commission has no justification or statutory authority to impose upon the Wisconsin apportionment formula a "California Twist Cap" method for determining the proper amount of tax to be paid by NCR. Finally, the department contends that the Commission erred in concluding that Wisconsin's "concentration" statute, sec. 71.04(4), Wis. Stats., violated the Equal Protection Clause when it failed to exempt NCR's "outside source" dividends for all years 1975-80 and its "inside source" dividends for the year 1980.

NCR challenges the Commission's conclusion that the Foreign Commerce Clause does not completely prohibit the inclusion of NCR's foreign-source income in its Wisconsin apportionable income. In the alternative, it argues that if such foreign-source income is apportionable, the Due Process Clause and the language of sec. 71.07(2), Wis. Stats., require that the payroll, property, and sales of its foreign subsidi-

aries must be included in the denominators of Wisconsin's apportionment formula. Finally, it contends that the "concentration" statute is unconstitutional with respect to the failure to exempt all dividends it received during the years 1975 through 1980, including its "inside-source" dividends for the years 1975-79.

NCR Corporation is incorporated in the State of Maryland and is engaged in the development, manufacture, and marketing of business machines. NCR is headquartered in Dayton, Ohio, but does business throughout all of the states of the United States and in many foreign countries. NCR conducts its business overseas through 18 branch offices and some 75 foreign subsidiaries incorporated in the countries in which they operate. With one exception, NCR owns all of the stock of these foreign subsidiaries, and it is undisputed that these foreign subsidiaries are unitary with NCR operations in the United States.

NCR receives three forms of income from its foreign subsidiaries. First, it registers foreign loan agreements for money loaned to the subsidiaries and receives interest on these loans. Second, it registers patents and licensing agreements on business machines and equipment it has developed and receives royalties from the subsidiaries on their sales of these products in their respective countries. Third, it receives dividends from the subsidiaries by virtue of its ownership of their stock.

Wisconsin employs a unitary business/formula apportionment method to determine the portion of the total business income of a corporation, subject to taxation in more than one state or jurisdiction, that is attributable to the corporation's business activity in Wisconsin. That Wisconsin-attributed income is then taxed as Wisconsin income.

In applying the apportionment formula, not all dividends are included in business income. Section 71.04(4), Wis. Stats., excludes from such income dividends received from predominantly Wisconsin-based companies while including in apportionable income dividends received from companies engaged in business primarily or entirely outside the state.

In its assessment for the years 1975 through 1980, the department included in NCR's apportionable income the interest, dividends, and royalties paid to NCR by its foreign subsidiaries. The property used, sales made, and payroll paid by the foreign subsidiaries, however, were not included in the denominators of the factor ratios in the formula. Nor did the department grant NCR a deduction for any dividends received from companies and subsidiaries whose principal business was not attributed to Wisconsin.

In 1980, sec. 71.04(4), Wis. Stats., was created to provide a deduction for 50 percent of dividends received from corporations in which the recipient owned 80% or more of the outstanding stock. For 1980, the department thus granted a partial deduction for all of the dividends paid by NCR's foreign subsidiaries, except the subsidiary based in Japan, as that subsidiary was only 70% owned by NCR.

The Circuit Court concluded the following:

A. Wisconsin's Concentration Statute — Deductible Dividends

The Commission properly reached the conclusion that "Wisconsin's concentration statute is a facial discrimination against that class of interstate businesses whose operations

are scattered across states in less-than-50% concentrations, as well as a discrimination against the shareholder-corporations of those businesses."

However, once facial discrimination is found to be present, as the Commission and the Court have concluded, the inquiry is at an end and no showing of "actual discriminatory impact" is required.

The dividends paid by NCR's subsidiaries in the years 1975 to 1979 were dividends for purposes of sec. 71.04(4), Wis. Stats., and the invalidity of this statute applies to them with the same force and effect as it does to the dividends of other payers.

The practical remedy for the Court's conclusion that sec. 71.04(4) is a discriminatory violation of the Interstate Commerce Clause is that all of NCR's dividends must be deducted from its Wisconsin apportionable income for the years in question. To deny the deduction to all taxpayers at this date, some 13 years later, is neither legally nor administratively possible; the department does not argue that this is the appropriate remedy.

The Court adopted the reasoning of the Commission and its conclusion that Wisconsin's "concentration" exemption violates the Equal Protection Clause. However, the violation applies to Wisconsin's taxation of all dividends paid to NCR during the years 1975 through 1980, including "inside-source" dividends.

B. Wisconsin's Apportionment Formula — Inclusion of Foreign-Source Income

There is no basis to conclude that the foreign-source interest and royalties

are constitutionally immune from taxation by Wisconsin.

While double taxation in fact is present if the Wisconsin scheme is sustained and close scrutiny is called for, when the nature of the subject of the tax and the tax systems themselves are considered along with the alternatives reasonably available to Wisconsin, the double taxation form here is not enough to render the Wisconsin scheme invalid. NCR's Foreign Commerce Clause challenge to Wisconsin's imposition of a tax on foreign-source interest and royalties must be rejected.

If the department's inclusion of foreign-source interest and royalties in the apportionable income base requires the concomitant inclusion of foreign subsidiary factors in the apportionment formula, it is not because of the internal consistency test.

The Court concluded that NCR has not proven by clear and cogent evidence that the income attributed by the department to Wisconsin is out of all appropriate proportions to the business transacted in Wisconsin, or has led to a grossly distorted result. On the contrary, the Wisconsin formula is a reasonable response in the imperfect world of multi-jurisdictional business taxation to the due process clause's admonition that a state may not "tax value earned outside of its borders."

Therefore, the Court remanded the matter to the Commission for further proceedings consistent with this decision.

(Note: At the time of this printing, it was not known whether the department or the taxpayer would appeal this decision.) □

— Depreciation — 1986 and prior; Depreciation — 1987 and thereafter. *Beatrice Cheese, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, February 24, 1993). The issues in this case are:

- A. Whether secs. 71.04(15)(b), Wis. Stats. (1983-85) and 71.26(3)(y), Wis. Stats. (1987), discriminate against interstate commerce by providing a direct commercial advantage to local businesses in violation of the Commerce Clause of the United States Constitution.
- B. Whether such provisions of the Wisconsin statutes allocate to Wisconsin a portion of Beatrice Cheese's total income which is out of all appropriate proportion to the business conducted by Beatrice Cheese within Wisconsin and leads to a grossly distorted result in violation of the Due Process Clause of the United States Constitution.

The taxpayer is engaged in the manufacture and sale of cheese and related products and during a part of the audit period had its principal offices in New Berlin, Wisconsin, and during a later part had them in Waukesha, Wisconsin. The taxpayer carried on a portion of its business within Wisconsin and a portion outside Wisconsin.

During the taxpayer's fiscal years 1984 through 1987, it carried on its business activities as three different corporations, each in turn changing their name to Beatrice Cheese and, therefore, this proceeding involves three separate assessments against the three different corporate entities each doing business as Beatrice Cheese. However, the dispute between the parties is the same with regard to each of the three entities.

On its Wisconsin franchise tax returns, the taxpayer claimed the amount of depreciation expense allowable under the Accelerated Cost Recovery System (ACRS) provided for in sec. 168, Internal Revenue Code, for the applicable tax year rather than the amount of depreciation expense allowable under sec. 71.04(15)(b), Wis. Stats. (1983-85) and sec. 71.26(3)(y), Wis. Stats. (1987).

In January 1990, the department issued three notices of field audit action against the taxpayer for taxable periods during fiscal years 1984 through 1987. The department disallowed the ACRS depreciation the taxpayer had claimed relative to property located outside Wisconsin on its Wisconsin franchise tax returns and allowed non-ACRS depreciation on the same property. The same adjustment was made for each of the respective tax periods in each of the notices.

The Commission concluded that:

- A. Secs. 71.04(15)(b), Wis. Stats. (1983-85) and 71.26(3)(y), Wis. Stats. (1987), discriminate against interstate commerce by providing a direct commercial advantage to businesses whose depreciable property is located in Wisconsin, in violation of the Commerce Clause of the United States Constitution.

These statutes specifically disallow accelerated depreciation expense ("ACRS") deductions for property located outside Wisconsin, but allow the more generous ACRS treatment for property located within Wisconsin.

The effect of this differential treatment is to impose a higher franchise tax burden on a

business solely because some or all of its depreciable property is located outside Wisconsin rather than inside the state of Wisconsin. This is clearly facial discrimination against interstate commerce.

- B. Since the statutes under review violate the Commerce Clause, no determination need be made by the Commission as to their validity under the Due Process Clause of the United States Constitution.

The department has not appealed this decision. □

— Interest — regular vs. delinquent. *William Wrigley, Jr., Co. vs. Wisconsin Department of Revenue* (Wisconsin Supreme Court, June 9, 1993). This case is on remand from the United States Supreme Court, which reversed the Wisconsin Supreme Court's February 19, 1991, decision that the department could not impose a franchise tax on the taxpayer.

The issue in this case, which the Wisconsin Supreme Court did not address in its previous decision, is whether the assessed taxes are delinquent and subject to an 18% penalty interest rate pursuant to sec. 71.13(1)(a), Wis. Stats. (1985-86), or an "additional" assessment under sec. 71.13(2), Wis. Stats. (1985-86), that did not become delinquent until 30 days following the U.S. Supreme Court's final determination on June 19, 1992, that the assessment was correct. See *Wisconsin Tax Bulletin* 78 (July 1992), page 8, for a summary of the U.S. Supreme Court decision.

The taxpayer, acting on the advice of counsel that it was immune from Wisconsin corporate franchise tax

under 15 USC sec. 381, did not file tax returns in Wisconsin for the years 1973 through 1978. In 1980, following an audit, the department issued a "Notice of Franchise Tax Assessment" informing the taxpayer that it owed "additional tax and interest" in the amount of \$246,641.04. The taxpayer appealed the assessment, and after litigation through the Wisconsin Court system, the U.S. Supreme Court in 1992 held that several of the taxpayer's activities were sufficient to subject it to taxation in Wisconsin.

There is no question that interest accrues on the unpaid taxes assessed against the taxpayer. At issue is whether interest accrues at the regular rate set forth in sec. 71.09(5)(a), Wis. Stats., or at the rate which penalizes delinquent taxpayers set forth in sec. 71.13(1)(a), Wis. Stats. (1985-86). Section 71.09(5)(a), Wis. Stats., was amended in 1981 to make a 12% rate applicable to all nondelinquent taxes assessed on or after August 1, 1981. Since the assessment here at issue was made prior to the amendment, the statute in effect as of the date of assessment applies, and the applicable nondelinquent rate is 6% per year for the years 1973 and 1974 and 9% per year for the years thereafter.

The Wisconsin Supreme Court concluded that under sec. 71.13(2), Wis. Stats. (1985-86), the assessment against the taxpayer did not become delinquent until 30 days following the U.S. Supreme Court's decision that the assessment was correct. Interest accrues at the regular rate set forth in sec. 71.09(5)(a), Wis. Stats., in effect in 1980, from the due date of the returns until 30 days following the U.S. Supreme Court decision.

The department has not appealed this decision. □

☛ Penalties — late-filing of returns. *Renaissance*

Construction, Inc. vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, December 14, 1992). The issue in this case is whether the taxpayer should be excused from a negligence penalty assessed by the department for the late filing of a corporation income tax return.

The taxpayer relied on the advice of its accountant that it would owe no taxes for 1989 and on a financial statement the accountant prepared showing, erroneously, that there was a loss for that year. As a result, the taxpayer's return was filed late and a negligence penalty assessed for late filing.

The Commission affirmed the department's penalty assessment, concluding that the legal duty to file a timely tax return falls on the taxpayer, not the accountant, and there is no provision or principle in the law that allows a taxpayer to delegate that duty to another. There was a knowing disregard of the duty to file, the taxpayer having known both actually and constructively (by being presumed to know the law) that it had a duty to file the return by the filing deadline.

The taxpayer 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. □

☛ Unitary business. *Chilstrom Erecting Corp. vs. Wisconsin Department of Revenue* (Court of Appeals, District I, February 23,

1993). The taxpayer appeals from an order of the Circuit Court confirming a franchise tax assessment for the years 1981 through 1985.

The taxpayer had argued that the department's adjustments to the franchise tax returns were improper because its in-state and out-of-state operations were not a unitary business entity and, therefore, its out-of-state income is not subject to taxation by the State of Wisconsin. Rather, the taxpayer claimed, the income had been properly reported through a separate accounting, which attributed all of the out-of-state income to the state in which the individual joint ventures operated. See *Wisconsin Tax Bulletin 70* (January 1991), page 12 and *Wisconsin Tax Bulletin 74* (October 1991), page 16, for summaries of prior decisions in this case.

The issues presented on appeal are:

- A. Whether the Wisconsin Tax Appeals Commission's (Commission) factual findings regarding the relationship between the taxpayer's in-state and out-of-state operations are supported by the record.
- B. Whether the taxpayer's Wisconsin operations and eight out-of-state joint ventures comprised a unitary business that was subject to apportionment of taxable income under sec. 71.07(2), Wis. Stats. (1985-86), and in accordance with the Due Process Clause of the Fourteenth Amendment of the United States Constitution.

From 1981-85, the taxpayer was a Wisconsin corporation with its principal place of business in Milwaukee, Wisconsin. The taxpayer was in the business of placing reinforced steel in concrete for the