



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

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INDIVIDUAL INCOME TAXES

— **Joint returns — joint and several liability.** *Tracy A. Smith vs. Wisconsin Department of Revenue* (Circuit Court for Barron County, April 7, 1994). This is a petition for review of a Wisconsin Tax Appeals Commission ("Commission") decision, dated October 19, 1993. The issue is whether the taxpayer is jointly and severally liable for the income tax on a capital gain from the sale of a residence owned jointly with Kum C. Smith, his wife at the time of the sale.

The department assessed income tax for 1987 on the taxpayer and Kum C. Smith, for a capital gain on the sale of their jointly owned residence. The taxpayer filed a petition for redetermination with the department, protesting the amount of the assessment on the grounds that his "ex-wife Kum had been 'awarded 60% of this money on the judgment'." The department denied the petition and sent notices to both the taxpayer and Kum C. Smith, who were divorced. The taxpayer filed a petition with the Commission, alleging that the department was "billing the wrong person" and that "the money in question was granted to my ex-wife, Kum Cha Smith ... in our divorce ... in March 1990." The taxpayer did not contest the taxability of the capital gain nor the correctness of the amount of the assessment; rather, he contended that "the only money he had was being held by the bankruptcy trustee."

In its decision the Commission found that since the taxpayer and Kum C. Smith filed a joint Wisconsin income tax return for 1987 they were jointly and severally liable for the amounts due. The Commission further held that it was immaterial that the proceeds

from the sale of the residence went to Kum C. Smith or that the taxpayer's funds were tied up in bankruptcy.

The Circuit Court concluded that the Commission decision was proper, and that there is no legal basis for reversal. There is no basis in law for the taxpayer's argument that the spouse who received all the benefits should be taxed the entire tax penalty.

The taxpayer has not appealed this decision. □

— **Nonresidents — S corporation liquidations.** *William W. and Cecelia G. Hansen, and Harry D. and Nancy W. Jacobs, Jr. vs. Wisconsin Department of Revenue* (Circuit Court for Dane County, December 8, 1994).

The issue in this case is whether the disparity of income tax treatment between Wisconsin residents and nonresidents is unconstitutional. The Tax Appeals Commission held that the taxpayers did not meet their burden of proof regarding constitutionality. See *Wisconsin Tax Bulletin 89* (October 1994), page 12, for a summary of the Commission decision.

The department and the taxpayers settled the issue under a Stipulation. They agreed that the tax due by the taxpayers was the amount that would be due if they were Wisconsin residents.

The Circuit Court issued an order modifying the Commission decision in accordance with the Stipulation. The Court then dismissed the petition of the taxpayers, without costs to either party. □

— **Retirement funds exempt — constitutionality.** *John D. and Jane A. Hennick vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, December 5, 1994). The issues in this case are:

- A. Whether the taxpayers have established that sec. 71.05(1)(a), Wis. Stats., as applicable to members of exempt groups identified by that statute for 1989 through 1992, violates Art. VIII, Section 1 of the Wisconsin Constitution, by failing to qualify as a “reasonable exemption” provision from “taxes ... imposed on incomes, privileges and occupations.”
- B. Whether the taxpayers have established that sec. 71.05(1)(a), Wis. Stats., violates the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution.

Taxpayer John D. Hennick was employed from 1956 through 1983 by a private employer. After retiring in 1983, he received annual pension payments from an insurance company, because of contributions made to a retirement fund pursuant to his service with his former employer.

The taxpayers filed amended Wisconsin income tax returns for 1989 through 1992, excluding the annual pension payments received by Mr. Hennick. The department denied the refund claims in full.

The Commission concluded as follows:

- A. The taxpayers have failed to establish that sec. 71.05(1)(a), Wis. Stats., as applicable to members of exempt groups identified by that statute for 1989 through 1992, violates Art. VIII, Section 1 of the Wisconsin Constitution, by failing to qualify as a “reasonable exemption” provision

from “taxes ... imposed on incomes, privileges and occupations.” The mere establishment of a difference in the taxation treatment accorded certain types of incomes does not *per se* indicate that those differences result from distinctions made through legislative enactments which are not reasonable.

- B. The taxpayers have failed to establish that sec. 71.05(1)(a), Wis. Stats., violates the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution. They have failed to prove that the state’s income taxation of pensions, as reflected in the exemptions in sec. 71.05(1)(a), Wis. Stats., results in “palpably arbitrary” differences in the treatment of taxpayers, lacking in any reasonable consideration of difference or policy which may inform the enactment.

The taxpayers have appealed this decision to the Circuit Court.

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. □

CORPORATION FRANCHISE AND INCOME TAXES

— **Apportionment — contractors; Losses — 1986 and prior — deductibility.** *Wisconsin Department of Revenue vs. Towne Realty, Inc.* (Circuit Court for Milwaukee County, September 28, 1994). The department filed a petition for review of the December 14, 1993, decision by the Wisconsin Tax Appeals Commission. See *Wisconsin Tax Bulletin 86* (April 1994), page 15, for a summary of that decision.

The department and the taxpayer reached a settlement of all claims relating to this case. They agreed to adjust Towne’s net business loss carryforward as recalculated. They also agreed that their settlement did not admit the correctness of either party’s position and did not establish a standard to apply to Towne’s returns outside the years under review.

Based on this information, the Circuit Court dismissed the case with prejudice on September 28, 1994. □

— **Transitional rules — federalization.** *Lincoln Savings Bank, S.A., f/k/a Lincoln Savings and Loan Association, vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, January 12, 1995). The issue in this case is whether the taxpayer’s federal bad debt reserve balance as of December 31, 1961, constitutes an “amount that, because of [1987 Wisconsin Act 27], is required to be added to, or subtracted from, income in order to avoid the double inclusion, or omission, of any item of income, loss or deduction,” as a component of any transitional adjustment to be made under sec. 3047(1)(a) of 1987 Wisconsin Act 27.

Lincoln Savings Bank (Lincoln), formerly known as Lincoln Savings and Loan Association, is, and during the taxable periods in issue was, a state-chartered savings bank duly organized, existing, and authorized to do business under the laws of the State of Wisconsin, having its principal offices located in Milwaukee, Wisconsin.

Lincoln is, and during the taxable periods in issue was, a corporation within the meaning of sec. 3047(1)(a) of 1987 Wisconsin Act 27 (the Act).

Section 3047(1)(a) of the Act, effective for taxable year 1987 and at all

times material hereto, provided in relevant part:

Each corporation shall calculate, as of the close of its taxable year 1986, the amount that, because of this act, is required to be added to, or subtracted from, income in order to avoid the double inclusion, or omission, of any item of income, loss or deduction ... If the amount required to be added or subtracted is more than \$25,000, it shall be added or subtracted in amounts as nearly equal as possible over the 5 taxable years beginning with 1987 ...

For purposes of determining its yearly transitional adjustment allowable under sec. 3047(1)(a) of the Act, Lincoln calculated, as of the close of its taxable year 1986, the difference between its Wisconsin bad debt reserve and its federal bad debt reserve as \$1,016,144. Starting with its taxable year 1987, it subtracted one-fifth of that amount (\$203,229) from its Wisconsin taxable income as otherwise determined.

It is the department's position that Lincoln's federal bad debt reserve must be reduced by the amount in Lincoln's bad debt reserve as of December 31, 1961 (immediately prior to the period during which it first became subject to Wisconsin franchise taxes). That federal balance was \$309,743. Accordingly, the department's position is that Lincoln's annual transitional adjustment for this item under sec. 3047(1)(a) of the Act be computed as follows:

a. Federal bad debt reserve reserve balance as of 12/31/86	\$3,684,766
b. Minus federal bad debt debt reserve balances of 12/31/61	<u>(309,743)</u>

c. Applicable federal bad debt reserve balance as of 12/31/86	\$3,375,023
d. Wisconsin bad debt reserve balance as of 12/31/86	<u>2,668,622</u>
e. Aggregate transitional adjustment (c minus d)	\$ 706,401
f. Yearly transitional adjustment (e divided by 5)	\$ 141,280

The Commission concluded that the department correctly disallowed portions of transitional subtraction modifications taken by the taxpayer during the years under review to the extent that those adjustments contained increments of the taxpayer's federal bad debt reserve balance as of December 31, 1961.

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

SALES AND USE TAXES

— Admissions — boat operator's receipts. *La Crosse Queen, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, January 11, 1995). The issue in this case is whether the taxpayer's receipts from excursion trips on the Mississippi River are subject to Wisconsin sales tax.

The taxpayer operated a seasonal (May through October) excursion vessel on the Mississippi River under a water carrier permit issued by the Interstate Commerce Commission.

The taxpayer advertised its excursion trips as 1 1/2-hour sightseeing and dinner cruises. Its vessel carried only passengers, with no other merchan-

dise, on round trip sightseeing and dinner cruises originating and returning to its wharf in La Crosse, with no intermediate stops. Its passengers/customers came from Wisconsin, Minnesota, and other locations.

On its trip north, the vessel loaded at its wharf in La Crosse, traveled up river several miles, and then returned. On its trip south, the vessel traveled several miles, turned around, and returned.

The taxpayer has claimed exemption from sales tax under sec. 77.54(13), Wis. Stats., which exempts from sales tax:

“The gross receipts from the sales of and the storage, use or other consumption in this state of commercial vessels and barges of 50-ton burden or over primarily engaged in interstate or foreign commerce or commercial fishing, and the accessories, attachments, parts and fuel therefor.”

The department concedes that the vessel at issue is a commercial vessel of 50-ton burden or over, but challenges that it is primarily engaged in interstate commerce.

The Commission concluded that the taxpayer is not primarily engaged in interstate commerce and is not entitled to the exemption from sales tax contained in sec. 77.54(13), Wis. Stats. There is no integral step in interstate movement or essential part of any interstate journey for the taxpayer's passengers, who embark and disembark at the same location in La Crosse. Their travel to and from interstate destinations is wholly independent of whether they ride the taxpayer's vessel.

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

← Parking and storage — aircraft; Containers, packaging and shipping materials — plastic garment bags. *Luetzow Industries vs. Wisconsin Department of Revenue* (Circuit Court for Milwaukee County, April 15, 1994). The issues in this case are:

- A. Whether gross receipts from airplane hangar leases are subject to or exempt from sales tax.
- B. Whether gross receipts from sales of garment bags to dry cleaning

establishments are subject to or exempt from sales tax.

The Circuit Court for Milwaukee County previously issued a decision in this case, on May 15, 1991. See *Wisconsin Tax Bulletin* 75 (January 1992), page 13, for a summary of that decision.

The Court of Appeals dismissed the department's October 23, 1991 petition for review of the Milwaukee County Circuit Court's May 15, 1991 decision, on the basis that the Circuit Court decision was not a final order.

The Circuit Court issued a final judgment on April 15, 1994. The Court concluded as follows:

- A. The airplane hangar lease receipts are subject to sales tax.
- B. The gross receipt from the sale of garment bags to dry cleaning establishments are exempt from sales tax.

The department appealed the April 15, 1994 decision to the Court of Appeals on July 12, 1994. □



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

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2. Medical Care Insurance Deduction — Nursing Home Insurance (p. 16)
3. Medical Care Insurance Deduction — Premiums Paid By a Statutory Employee and Former Employee (p. 16)
4. Separate Returns Filed After Joint Return (p. 17)
5. Treatment of Tax-Option (S) Corporation Items When Stock Is Held By a Grantor Trust (p. 18)

Corporation Franchise and Income Taxes

6. Making or Withholding an Election Not to Be a Tax-Option (S) Corporation for Wisconsin (p. 18)
7. Tax-Option (S) Corporation's Treatment of Certain Exempt Bond Interest (p. 20)

Sales and Use Taxes

8. Claims for Refund — Construction Activities (p. 21)
9. Claims for Refund — Seller With Tax Delinquency (p. 21)
10. Claims for Refund — Time Limitations (p. 22)
11. Use Tax On Building Materials Stored in Wisconsin (p. 27)

Local Exposition Taxes

12. Local Exposition Taxes — Brackets for Collecting Taxes From Customers (p. 28)
13. Local Exposition Taxes — Food and Beverage Tax — Sales of Beer and Liquor (p. 29)
14. Local Exposition Taxes — Food and Beverage Tax — Sales of Soda (p. 29)
15. Local Exposition Taxes — Food and Beverage Tax — Off-Premises Consumption (p. 30)
16. Local Exposition Taxes — Food and Beverage Tax — Gift Baskets (p. 31)
17. Local Exposition Taxes — Rental Car Tax — Rental of Service or Replacement Vehicles (p. 32)